ANNUAL REPORT

of the Secretary of the Treasury on the State of the Finances

FISCAL YEAR 1979

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DEPARTMENT OF THE TREASURY

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Secretary

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THE SECRETARY OF THE TREASURY
WASHINGTON

February 5, 1980

Dear Sirs:

I have the honor to transmit to you a report on the state of the finances of the United States Government for the fiscal year ended September 30, 1979. This submission is in accordance with 31 U.S.C. 1027.

Sincerely yours,

G. William Miller

President of the Senate
Speaker of the House of Representatives

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NOTE.—Details of figures may not add to totals due to rounding.

The tables to this Annual Report will be published in the separate Statistical Appendix.

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Secretaries, Deputy Secretaries, Under Secretaries, General Counsel, Assistant Secretaries, and Treasurer of the United States serving in the Department of the Treasury from January 21, 1977, through September 30, 1979[1]

Term of service From	To	Officials
		Secretaries of the Treasury:
Jan. 23, 1977	Aug. 4, 1979	W. Michael Blumenthal, Michigan.
Aug. 7, 1979	....	G. William Miller, California.
		Deputy Secretaries:
Mar. 3, 1976	Jan. 23, 1977	George H. Dixon, Minnesota.
May 3, 1977	....	Robert Carswell, New York.
		Under Secretary for Monetary Affairs:
Mar. 30, 1977	....	Anthony M. Solomon, Virginia.
		Under Secretary (Counselor):
Mar. 30, 1977	....	Bette B. Anderson, Georgia.
		General Counsel:
Aug. 4, 1977	....	Robert H. Mundheim, Pennsylvania.
		Assistant Secretaries:
Apr. 11, 1972	Apr. 28, 1977	Warren F. Brecht, Connecticut.
Feb. 28, 1977	Dec. 7, 1977	Laurence N. Woodworth, Maryland.
Mar. 30, 1977	....	Gene E. Godley, District of Columbia.[2]
Mar. 31, 1977	....	C. Fred Bergsten, New York.[2]
Apr. 29, 1977	....	Roger C. Altman, New York.
Apr. 29, 1977	Nov. 15, 1978	William J. Beckham, Jr., Michigan.
Apr. 29, 1977	....	Joseph Laitin, Maryland.
May 16, 1977	Sept. 30, 1979	Daniel H. Brill, Maryland.
Jan. 30, 1978	....	Richard J. Davis, New York.
June 26, 1978	....	Donald C. Lubick, Maryland.
July 3, 1979	....	W. J. McDonald, District of Columbia.
		Fiscal Assistant Secretaries:
July 29, 1975	Dec. 31, 1977	David Mosso, Virginia.
July 5, 1978	....	Paul H. Taylor, Maryland.
		Treasurer of the United States:
Aug. 3, 1977	....	Azie T. Morton, Virginia.

[1] For officials from Sept. 11, 1789, to Jan. 20, 1977, see exhibit 62, 1977 Annual Report.

[2] Act of May 18, 1972, provided for two Deputy Under Secretaries, to be designated Assistant Secretaries by the President as desired.

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PRINCIPAL ADMINISTRATIVE AND STAFF OFFICERS OF THE DEPARTMENT OF THE TREASURY AS OF SEPTEMBER 30, 1979

Secretary of the Treasury	G. William Miller
Deputy Secretary of the Treasury	Robert Carswell
Under Secretary for Monetary Affairs	Anthony M. Solomon
Under Secretary	Bette B. Anderson
General Counsel	Robert H. Mundheim
Office, Secretary of the Treasury:	
Executive Assistant to the Secretary	Randall K. C. Kau
Executive Assistant to the Secretary	(Vacancy)
Confidential Assistant to the Secretary	Lisa Astudillo
Office, Deputy Secretary of the Treasury:	
Inspector General	Leon Wigrizer
Executive Assistant to the Deputy Secretary	Paul L. Lee
Executive Secretary	Randall K. C. Kau
Deputy Executive Secretary	Steven L. Skancke
Special Assistant to the Secretary (National Security)	J. Foster Collins
Office, Under Secretary for Monetary Affairs:	
Assistant Secretary (International Affairs)	C. Fred Bergsten
Deputy Assistant Secretary for Trade and Investment Policy	Gary C. Hufbauer
Deputy Assistant Secretary for Commodities and Natural Resources	Charles Schotta (acting)
Deputy Assistant Secretary for International Monetary Affairs	F. Lisle Widman
Deputy Assistant Secretary for Developing Nations	Arnold Nachmanoff
Deputy to the Assistant Secretary for Saudi Arabian Affairs	Leamon R. Hunt
Deputy to the Assistant Secretary and Secretary of IMG (International Monetary Group)	George H. Willis
Inspector General	Weir M. Brown
Fiscal Assistant Secretary	Paul H. Taylor
Deputy Fiscal Assistant Secretary	Gerald Murphy
Assistant Fiscal Assistant Secretary (Banking)	John A. Kilcoyne
Assistant Fiscal Assistant Secretary (Financing)	Philip J. Fitzpatrick
Assistant Fiscal Assistant Secretary (Planning and Research)	Lester W. Plumly
Office, Under Secretary:	
Special Assistant to the Under Secretary	Faye P. Hewlett
Special Projects Officer	Felix S. Williams
Assistant Secretary (Administration)	W. J. McDonald
Deputy Assistant Secretary (Administration)	Martha A. Thompson
Director, Office of Administrative Programs	Robert R. Fredlund
Director, Office of Audit	Wilbur R. DeZerne

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Director, Office of Budget and Program Analysis	Arthur D. Kallen
Director, Office of Computer Science	Francis A. McDonough
Director, Office of Equal Opportunity Program	David A. Sawyer
Director, Office of Management and Organization	(Vacancy)
Director, Office of Personnel	(Vacancy)
Assistant Secretary (Enforcement and Operations)	Richard J. Davis
Deputy Assistant Secretary (Operations)	John P. Simpson
Deputy (Regulatory and Trade Affairs)	Stephen M. Creskoff
Director, Office of Operations	John W. Mangels
Deputy Assistant Secretary (Enforcement)	William W. Nickerson
Director, Foreign Assets Control	Stanley L. Sommerfield
Director, Interpol (National Central Bureau)	Louis B. Sims
Treasurer of the United States	Azie T. Morton
Assistant to the Treasurer of the United States	Darryl H. Fagin
Office, General Counsel:	
Deputy General Counsel	David R. Brennan
Assistant General Counsel and Chief Counsel, Internal Revenue Service	Lester Stein (acting)
Assistant General Counsel	Wolf Haber
Assistant General Counsel	Russell L. Munk
Assistant General Counsel	Jordan A. Luke
Assistant General Counsel	Luke D. Lynch (acting)
Counselor to the General Counsel	Forest D. Montgomery
Director of Practice	Leslie S. Shapiro
Deputy Assistant Secretary (Tariff Affairs)	Peter D. Ehrenhaft
Assistant Secretary (Tax Policy)	Donald C. Lubick
Deputy Assistant Secretary (Tax Policy)	Daniel I. Halperin
Deputy Assistant Secretary (Tax Policy) (Tax Analysis)	Emil M. Sunley
Associate Director, Office of Tax Analysis	Harvey Galper
Tax Legislative Counsel	John M. Samuels
International Tax Counsel	H. David Rosenbloom
Director, Office of Industrial Economics	Karl Ruhe
Assistant Secretary (Legislative Affairs)	Gene E. Godley
Deputy Assistant Secretary (Legislative Affairs)	Colbert I. King
Deputy Assistant Secretary (Legislative Affairs)	B. Alexander Kress
Special Assistant to Assistant Secretary	Geoffrey G. Peterson
Special Assistant to Assistant Secretary	E. Douglas Frost
Assistant Secretary (Economic Policy)	Daniel H. Brill
Executive Assistant	George C. Miller, Jr.
Deputy Assistant Secretary (Economic Policy)	Beatrice N. Vaccara
Director, Office of Financial Analysis	John H. Auten
Director, Office of Special Studies	Maynard S. Comiez
Deputy Assistant Secretary for International Economic Analysis	John R. Karlik
Director, Office of Data Services	Robert Brown
Director, Office of Balance of Payments	Donald Curtis
Director, Office of Monetary Research	Jacob Dreyer (acting)
Director, Office of Trade Research	J. Michael Finger
Director, Office of International Energy Research	Cathryn Goddard

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Director, Foreign Portfolio Investment Survey	Leo Maley
Assistant Secretary (Domestic Finance)	Roger C. Altman
Deputy Assistant Secretary for Capital Markets Policy	John J. Mingo
Director, Office of Securities Markets Policy	Philip C. Loomis
Director, Office of Capital Markets Legislation	Gordon Eastburn
Deputy Assistant Secretary for State and Local Finance	Robert W. Rafuse, Jr.
Director, Office of Municipal Finance	(Vacancy)
Director, Office of New York Finance	John J. McLaughlin
Deputy Assistant Secretary (Debt Management)	Richard M. Kelly
Senior Adviser (Debt Research)	(Vacancy)
Director, Office of Government Financing	Francis X. Cavanaugh
Director, Office of Market Analysis and Agency Finance	Roland H. Cook
Director, Office of Revenue Sharing	(Vacancy)
Assistant Secretary (Public Affairs)	Joseph Laitin
Deputy Assistant Secretary	Everard Munsey

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

Director	G. R. Dickerson
Deputy Director	Stephen E. Higgins
Assistant Director (Administration)	William J. Rhodes
Assistant Director (Criminal Enforcement)	Miles N. Keathley
Assistant Director (Inspection)	Donald Zimmerman
Assistant Director (Regulatory Enforcement)	William T. Drake (acting)
Assistant Director (Technical and Scientific Services)	Michael Hoffman
Chief Counsel	Marvin J. Dessler

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Comptroller of the Currency	John G. Heimann
Executive Assistant to the Comptroller	James W. Montanari
Senior Advisor to the Comptroller	Charles E. Lord
Senior Deputy Comptroller	Lewis G. Odom
Senior Deputy Comptroller for Operations	H. Joe Selby
Senior Deputy Comptroller for Policy Planning	Cantwell F. Muckenfuss
Senior Deputy Comptroller for Bank Supervision	Paul M. Homan
Deputy Comptroller (Special Surveillance)	William E. Martin
Deputy Comptroller (Administration)	James T. Keefe
Deputy Comptroller (Specialized Examinations)	Dean E. Miller
Deputy Comptroller (Research and Economic Programs)	William A. Longbrake
Deputy Comptroller (Interagency Coordination)	David C. Motter
Deputy Comptroller (Multinational Banking)	Billy C. Wood
Chief National Bank Examiner	(Vacancy)
Special Assistant to the Comptroller	George A. Cincotta
Special Assistant to the Comptroller	Susan Wagner
Special Assistant to the Comptroller	Royal B. Dunham, Jr.
Special Assistant to the Comptroller	Stuart J. Gordon
Special Assistant to the Comptroller (Congressional Affairs)	Donald A. Melbye
Deputy Director (Communications)	Caryl A. Austrian
Director, Bank Organization and Structure	James V. Elliott

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Deputy Director Comptroller (Customer and Community Programs)	Jo Ann Barefoot
Director (Customer Programs)	(Vacancy)

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Commissioner of Customs	Robert Chasen
Deputy Commissioner	William T. Archey
Assistant Commissioner (Border Operations)	Vernon V. Hann
Assistant Commissioner (Office of Commercial Operations)	Alfred R. DeAngelus
Director (Office of Regulations and Rulings)	Donald W. Lewis
Comptroller	Jack Lacy
Director (Office of Investigations)	William Green
Assistant Commissioner (Office of Management Integrity)	George C. Corcoran, Jr.
Chief Counsel	Thaddeus Rojek

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Assistant Director (Operations)	(Vacancy)
Assistant Director (Research and Engineering)	Milton J. Seidel

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Associate Director for Training	David W. McKinley (acting)
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Assistant Director (Police Training Division)	Peter Phillips (acting)
Assistant Director (Special Training Division)	(Vacancy)
Assistant Director (Washington Liaison Office)	John C. Dooher

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Deputy Commissioner	(Vacancy)
Assistant Commissioner, Administration	George L. McConville
Assistant Commissioner, Comptroller	Steve L. Comings
Assistant Commissioner, Banking and Cash Management	Lloyd L. Morgan
Assistant Commissioner, Disbursements and Claims	Michael D. Serlin
Assistant Commissioner, Government-wide Accounting	John O. Turner

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Assistant Commissioner (Resources Management)	Joseph T. Davis
Assistant Commissioner (Compliance)	Singleton B. Wolfe
Assistant Commissioner (Employee Plans and Exempt Organizations)	S. Allen Winborne
Assistant Commissioner (Inspection)	Robert L. Rebein
Assistant Commissioner (Planning and Research)	Russell E. Dyke

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Assistant Commissioner (Technical)	Gerald G. Portney (acting)
Assistant Commissioner (Data Services)	Donald J. Porter
Chief Counsel	Lester Stein (acting)

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Director	Stella B. Hackel
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Assistant Director for Marketing and Statistical Services	Francis B. Frere
Assistant Director for Production	Galen Dawson
Assistant Director for Technology	Alan J. Goldman
Assistant Director for Personnel	James J. Mulcahy

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Deputy Commissioner	William M. Gregg
Assistant Commissioner (Washington)	Kenneth W. Rath
Assistant Commissioner (Field)	Martin French
Chief Counsel	Calvin Ninomiya

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Deputy National Director	Jesse L. Adams, Jr.
Director of Sales	Walter R. Niles
Director of Advertising and Promotion	Louis F. Perrinello

UNITED STATES SECRET SERVICE

Director	H. Stuart Knight
Deputy Director	Myron I. Weinstein
Assistant Director (Protective Research)	Arnold Lau
Assistant Director (Investigations)	Robert E. Powis
Assistant Director (Protective Operations)	John R. Simpson
Assistant Director (Inspection)	Horace Gibbs
Assistant Director (Administration)	Robert Burke (acting)

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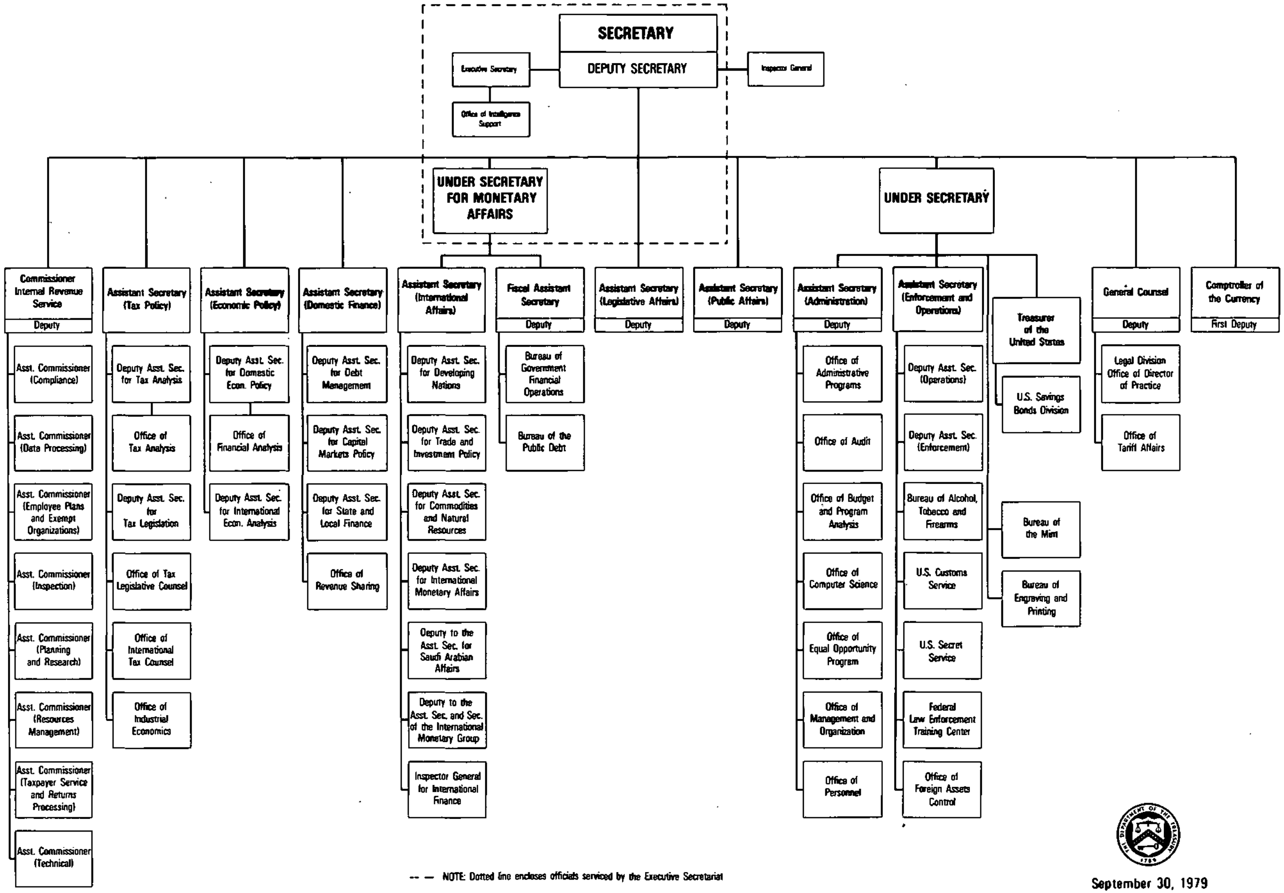
ORGANIZATION OF THE DEPARTMENT OF THE TREASURY



-- -- NOTE: Dotted line encloses officials serviced by the Executive Secretariat

September 30, 1979

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INTRODUCTION

This section reviews developments which affected areas of Treasury interest and responsibility during fiscal 1979. Only major domestic and international developments are covered since detailed information on the operating and administrative activities of the Department is provided in the body of the report. Statistical information is presented in the separate Statistical Appendix.

DOMESTIC DEVELOPMENTS

The Economic Expansion

The economic upswing which began at the end of the first quarter of 1975 faltered somewhat during fiscal 1979. The first quarter of the fiscal year registered relatively strong growth, and the final quarter was unexpectedly buoyant. Real GNP at the close of fiscal 1979 was 1.8 percent higher than a year earlier. Fiscal 1978 saw a 3.9-percent increase. The most disturbing domestic economic development in fiscal 1979 was a resurgence of inflation averaging about 9½ percent as measured by the fixed weight GNP deflator.

As in 1978, the economic growth during 1979 was interrupted by severe winter weather. Unlike 1978, however, a rebound did not follow in the second quarter of the calendar year. Instead, real GNP declined that quarter at a 2.3-percent annual rate. In retrospect, it is clear that special factors were a major influence in the decline in economic activity in the second quarter. The Teamsters strike disrupted production patterns early in the quarter, while reduced and uncertain availability of gasoline cut into consumer demand late in the quarter. At the time, the decline led many observers to believe the recession expected in the latter half of calendar 1979 had begun. But the resumption of growth—at a 3.1-percent annual rate—in the final quarter of fiscal 1979 clouded the picture and made assessment of the economy's momentum less certain.

During the course of the fiscal year, economic policy shifted increasingly toward controlling inflation. The unemployment rate remained low despite slower economic growth while the inflation rate, particularly as reflected in the Consumer Price Index, accelerated and proved resistant to measures aimed at bringing it down. Domestic costs and prices received a further upward jolt in the early summer when the Organization of Petroleum Exporting Countries imposed an additional price increase of some 60 percent on imported crude oil.

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Personal consumption spending was a key element in shaping the pattern of economic developments during fiscal 1979, rose by about 2.3 percent in real terms, down significantly from a 4.8-percent increase in the previous fiscal year, but about in line with the 2.2-percent rise in real final sales during the fiscal year. However, the quarterly pattern of consumption expenditures was extremely uneven.

After a brisk start during the first quarter of the fiscal year, consumer spending sagged during the next two quarters before showing surprising strength again in the final fiscal quarter. The weakness in the second quarter probably reflected adverse weather conditions, but the failure of the economy to rebound in the succeeding quarter requires other explanations. Possible alternatives are that the weakness represented a real retrenchment by consumers, that it was a reflection of the acceleration of price increases, or that recovery was forestalled by short gasoline supplies. The rebound in real consumer outlays in the final quarter of the fiscal year when supplies of gasoline were more readily available underscores the third explanation as the probable cause of the slowdown.

Previously, spending had been growing at a rate in excess of income growth and had depressed the personal saving rate to 4.7 percent, the lowest rate since the early 1960's—except for the first quarter of 1977. In the two weak quarters the personal saving rate moved up to 5.0 percent, then 5.4 percent. In the final quarter of fiscal 1979, however, it decreased to 4.3 percent.

Inflation also accelerated markedly in the second quarter. As measured by the implicit price deflator for personal consumption expenditures, inflation accelerated from a 6.9-percent annual rate in the first quarter to 10.8 percent in the second. The pace eased to around 9½ percent during the latter half of the year. Rising prices kept nominal retail sales climbing all during the period of weakness in real retail sales, thus adding some support to the inflation explanation of consumer behavior. However, the resurgence of retail sales in the final quarter of the fiscal year in the face of high rates of inflation was difficult to explain, as was the apparent upturn in some of the major indexes of consumer confidence. At the end of the fiscal year, neither basic consumer attitudes on the likely course of economic activity nor their reactions to inflation were very clear.

Investment spending exhibited noticeable gyrations during fiscal 1979. Real gross private domestic investment (which includes fixed residential and nonresidential investment, as well as inventory investment) dipped lower in the second quarter, contributing to the lackluster growth of that period. It expanded at an 8.5-percent annual rate during the third quarter (when real GNP declined) and was down a sharp 12.8-percent annual rate in the last quarter (when real GNP growth resumed). Swings in inventory investment were the main factors in that jagged pattern. After three consecutive quarters of steady increases at about a $12 billion annual rate, inventory additions suddenly jumped by about 50 percent in the third quarter of the fiscal year (to an $18.1 billion annual rate), then dropped back to $7.1 billion in the final

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quarter when consumer spending accelerated, partly under the stimulus of sales incentive contests and rebates in the auto industry.

Business inventory-sales ratios (in real terms) drifted higher as the year progressed. Most of that increase reflected a rise at the manufacturing level. Wholesale inventory-sales ratios were virtually unchanged from the previous year, while the slight drift upward in retail inventories of autos was offset elsewhere in that sector, thus keeping the retail inventory-sales ratios (in real terms) at the end of the fiscal year 1979 equal to that of a year earlier.

The pattern of fixed investment during the course of the year paralleled that of the overall economy. Nonresidential fixed investment started and ended the fiscal year strongly, with annual rates of growth around 11 percent in real terms. Second-quarter growth was substantially weaker and was followed by an 0.8-percent annual rate decline in the third quarter. A second-quarter drop in investment in structures, and then a large falloff in investment in producers' durable equipment, led to midyear weakness.

Residential fixed investment in real terms declined by 6.1 percent during the fiscal year, with each quarter registering a real decline from the quarter before. An especially sharp 14.3-percent annual rate decline was recorded during the second quarter of the year, but real spending continued to slide through the remainder of the year as construction activity was affected by tighter financial conditions and a more cloudy economic outlook.

Employment growth in fiscal 1979 was only about two-thirds as large as in 1978. It did, however, about match the growth in the labor force, leaving the total number of persons unemployed at yearend virtually unchanged from the year-earlier figure. Total employment increased by 2.5 million persons (2.6 percent). The unemployment rate stood at 5.9 percent in September 1978 and 5.8 percent in September 1979, reflecting the approximately equal growth in the labor force and in employment. During the year, the unemployment rate as a whole remained quite stable with a low of 5.6 percent (June) and a high of 6.0 percent (August).

The marginal improvement in the unemployment rate during the year solely reflected improved job opportunities for adult females. Their unemployment rate declined moderately over the year, from 5.9 percent to 5.5 percent. The unemployment rate of adult males remained essentially unchanged, moving up only 0.1 percent to 4.2 percent in September 1979. The high teenage unemployment rate also remained basically the same, 16.4 percent, as employment declined slightly more than this component of the labor force.

Inflation

The need to control inflation increased in fiscal 1979. At the beginning of the fiscal year, the Consumer Price Index for all urban workers was increasing at an annual rate of over 10 percent. Some improvement was recorded over the first quarter, but prices rose rapidly across the board in January. Food, energy, medical care, and homeownership prices all accelerated, with food and energy both moving up at annual rates in excess of 18 percent. The rise in food prices

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moderated substantially in the third and fourth quarters, but energy prices continued to surge throughout the year and increased at an annual rate of over 60 percent during the final quarter of fiscal 1979.

Industrial prices in all three major categories—crude materials, intermediate materials, and finished goods—rose at annual rates in excess of 15 percent during the final quarter.

Productivity in the nonfarm business sector of the economy in the final quarter of fiscal 1979 was 1.8 percent below the year-earlier figure. During the year, only the first quarter recorded a gain from the prior quarter (0.8 percent, annual rate), while declines were registered in each of the next three quarters (3.2 percent in the second, 4.1 percent in the third, and 0.8 percent in the fourth). Increases in compensation per hour were relatively steady at annual rates of around 9 percent. The combination of declining productivity and relatively constant rises in compensation per hour produced a rapid acceleration in unit labor costs. At the end of the fiscal year, unit labor costs were 10.9 percent higher than the previous year. The corresponding increase over the course of fiscal 1978 was 8.1 percent.

The Budget and Fiscal Developments

The budget estimates for fiscal 1979 presented in January 1979 called for outlays of $493.4 billion and revenues of $456 billion, leaving a deficit of $37.4 billion. Final figures for the year revealed outlays to have been $493.2 billion and revenues of $465.9 billion, producing a deficit of $27.3 billion. The major reason for the difference was higher than expected receipts, as employment and personal income performances exceeded the projections made at the time the budget was submitted in January.

Budget outlays for 1979 were very close to the January estimate, but only as a consequence of offsetting changes. The largest increases were for military procurement ($2.9 billion) and the Farmers Home Administration ($1.4 billion). The largest decreases were for the Commodity Credit Corporation ($1.5 billion) and military assistance programs ($1.4 billion).

Off-budget net outlays for fiscal 1979 were slightly larger than anticipated. In the January budget submission, such outlays were expected to amount to $12 billion. The actual figure was $12.4 billion, with an increase in outlays by the Federal Financing Bank from $11.5 to $13.3 billion being partially offset by a swing in the Postal Service from an expected deficit of $0.3 billion to a surplus of $0.9 billion.

Domestic Finance

The volume of funds raised by non-Federal borrowers in domestic financial markets continued to rise in 1979, especially in the short-term sector of the market, although at a slower pace than the increase in nominal GNP. With a smaller budget deficit, Federal demands for credit declined from the 1978 level. Aggregate nonfinancial credit flows were little changed from the 1978

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levels. At the same time, the atmosphere in money and credit markets was one of considerable uncertainty about the likely pace of economic activity, about the intensity of inflationary pressures, and about the course of fiscal and monetary policy in response to these economic problems.

The onset of what appeared to be a recessionary downturn in the spring of the year led many to suppose that some easing of monetary and fiscal policy could develop before the end of the year. Consequently, interest rates declined and demands on credit markets slackened in anticipation of more favorable borrowing costs in the future. In the event, the closing months of the fiscal year brought a renewed uncertainty as to whether the spring's events had been illusory. With inflationary pressures intensifying, demands for credit rose sharply, especially in the area of short-term bank lending.

Money supply growth over the year followed the quarterly pattern that has been characteristic of recent years: slow growth in the fourth and first calendar quarters and quite rapid advances in the remainder of the year. The final calendar quarter of 1978 witnessed only a small net growth in the basic money supply, in part because of shifts of funds from demand deposits to ATS and NOW accounts, which are not part of the traditional money supply data. M1 growth slowed even more in the early part of the new year and for the first quarter as a whole declined at a 2.1-percent annual rate. Unfortunately from a monetary policy standpoint, the second calendar quarter once again experienced a sharp acceleration in money growth. This more rapid pace of money growth continued throughout the summer. After the end of the fiscal year several monetary policy actions were taken, including (1) an increase in the discount rate from 11 to 12 percent, (2) the imposition of an 8-percent marginal reserve requirement on certain managed liabilities, and (3) a sharp redirection of Federal Reserve policy emphasis from a focus on money market conditions to one based on reserve availability.

With the money supply growing only modestly in the first two quarters of fiscal 1979, and with some evidence that a peak in the current cycle of economic activity was near, the monetary authorities made little effort to push interest rates to higher levels in the winter months. As a consequence, interest rates in the first half of the fiscal year fluctuated within a relatively narrow band, with the 13-week Treasury bill rate at about 9¾ percent, and the 90-day commercial paper and Federal funds rates around the 10-percent level. In light of the failure of the economy to weaken further after the slowdown in the spring, however, both market demands for credit and monetary policy actions in the final months of the fiscal year pushed rate levels in the short-term sector of the market sharply higher, and by the end of the fiscal year the 3-month bill rate had climbed to 10¼ percent and commercial paper to an 11¾-percent level.

In terms of credit demands by particular sectors, Treasury borrowing from the public totaled $33.6 billion in the fiscal year, compared with $59.1 billion in the fiscal year 1978. Of the $21.5 billion increase in interest-bearing marketable public debt over the fiscal year, a relatively small $442 million

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increase was in the Treasury bill sector. Marketable Treasury notes accounted for $6.4 billion of the total increase, while Treasury bonds, largely in the 20- to 30-year maturity category, increased by $14.7 billion in reflection of the Treasury's continuing efforts to lessen the burden of refinancing the public debt on the market through the extension of the maturity of its obligations into long-term securities.

Foreign official investment in marketable Treasury debt decreased $3.1 billion to $95.3 billion despite $3.6 billion in foreign "add-ons," i.e., augmented amounts to regular offerings of marketable issues. In addition, the Treasury sold just over $4 billion of nonmarketable foreign-currency-denominated securities, about equally divided between German marks and Swiss francs, in order to finance official activities in foreign exchange markets. In contrast to foreign currency borrowings in earlier years, these latter securities were issued not to official buyers, but to foreign private investors under registration arrangements that would preclude purchases by U.S. investors.

Business demands for credit in the fiscal year totaled $132 billion, $97 billion of which represented demands for short-term credit, of which $68 billion took the form of bank lending. Corporate bond offerings totaled $29.5 billion, while equity issued accounted for $5.75 billion. In terms of the sources of these funds, the greatest increase over previous years represented flows from Treasury-bill-rate-based market certificates issued by banks and thrift institutions or flows from money market mutual funds. Money market certificates issued by banks and thrift institutions increased by $169 billion over the fiscal year to an estimated $204 billion; funds raised by money market mutual funds totaled $35 billion, of which $9 billion represented funds received in the final quarter of the fiscal year.

State and local borrowing in the year rose less dramatically than other demands for credit, partly in reflection of a decline in the issuance of advance refunding bonds. In total, long-term State and local borrowing totaled $42.5 billion in the fiscal year, compared with the previous year's total of $48 billion.

The final major category of credit demands, consumer borrowing, either short-term or in the form of mortgage finance, was heavily influenced by economic developments over the course of the year. On the one hand, the intensification of the inflation pressures apparently led to anticipatory buying of both consumer durables and nondurables, sparking a $40.5 billion record rise in consumer credit in the year. For the same inflation-based reasons, housing and real property demands soared in the year, with the result that mortgage credit rose by $162 billion over fiscal 1978 to a level of $1.3 trillion despite an increase in the level of mortgage rates from about 9.60 percent at the beginning of the year to 10.49 percent in early summer and 10.72 percent at the end of the fiscal year.

Taxation Developments

Tax policy developments reflected the need for permanent tax reduction to reduce individual and business tax burdens; and to encourage economic

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stimulus, spending control, energy research and development, and tax simplification.

The Revenue Act of 1978 (Public Law 95–600), proposed January 21, 1978, was enacted November 6, 1978 (effective January 1, 1979). President Carter originally proposed a $25 billion net tax reduction program for fiscal 1979. The administration later recognized the need to get a better balance between monetary and fiscal policy; therefore, this proposal was trimmed to a total tax cut of $14.3 billion in fiscal 1979.

The final version of the Revenue Act of 1978 gave a reduction much higher than the original proposal. It provided new tax cuts of $21.3 billion in calendar 1979 and an extension of previously expiring cuts and added a reduction of $13.5 billion; therefore, the act provided tax cuts of $34.8 billion for calendar 1979.

Individuals received tax cuts equal to 40 percent of the entire Revenue Act. Capital gains taxes were reduced significantly and taxpayers aged 55 and older received a once-in-a-lifetime exclusion on gains of up to $100,000, realized on the sale of their principal residence.

Tax liability increased by $1.4 billion in calendar year 1979 by repeal of the itemized deduction for State and local gasoline taxes; and by taxation of unemployment compensation benefits paid to taxpayers with adjusted gross income (including benefits) above $20,000 for singles and $25,000 for joint returns.

To encourage formation and expansion of small business and increase investment generally, business tax reductions of about $5 billion were enacted in 1979. These cuts were established by reducing the top corporate tax rate from 48 percent to 46 percent and by creating a system of graduated tax rates for smaller corporations. Also, the investment tax credit was made permanent at a 10-percent rate.

On November 8, 1978, the Foreign Earned Income Act of 1978 was enacted. A U.S. citizen, living in a foreign country for 3 years or more, can use an exclusion based on excess cost of living (other than housing and education) due to living abroad.

The Energy Tax Act of 1978 was enacted on November 9, 1978, to reduce U.S. reliance on uncertain foreign energy supplies. This act imposed energy-related taxes and credits, resulting in a reduction in tax liability of $0.2 billion in fiscal 1979.

Real wage insurance, proposed in October 1978 and considered throughout 1979, was intended to encourage compliance with wage standards set by the President's Council on Wage and Price Stability. The credit rate was to be equal to the difference between the percentage increase in the Consumer Price Index and 7 percent (for fiscal 1979) with a maximum credit of 3 percentage points on wages up to $20,000.

After the April 1979 announcement that the administration was phasing out petroleum price controls between June 1, 1979, and October 1, 1981, oil companies were expected to reap billions of dollars of windfall profits due to

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the rising prices. The administration proposed a 50-percent windfall profits tax to be effective January 1, 1980. The windfall profits tax, estimated at $2.9 billion for fiscal 1980 and $9.3 billion for fiscal 1981, would be assigned to energy-related uses through an energy security trust fund. The House of Representatives passed H.R. 3919 (the Crude Oil Windfall Profits Tax Act of 1979) and it was still under Senate Finance Committee consideration at the close of fiscal 1979.

The administration proposed cash management measures that were not considered in fiscal 1979; however, Treasury will continue to support the issue. At the close of fiscal 1979, Congress had not completed action on proposed airport and airway trust fund taxes.

In fiscal 1979, the administration proposed legislation to distinguish between employees and independent contractors. Now, independent contractors receive more favorable withholding and social security tax treatment and there exists no clear method to show a distinction between the two groups. Congress did not act on this proposal.

INTERNATIONAL AFFAIRS

Background Survey of World Finance

Uncertainties over the availability of oil and the upward trend in oil prices dominated developments in the world economic situation in fiscal 1979. Revolution and continued political instability in Iran led to a sharp reduction in that country's output which had in fiscal 1978 provided more than 16 percent of the oil moving in international trade. The average price of internationally traded crude oil rose roughly 73 percent in the course of U.S. fiscal 1979. By the end of December 1979, the average price of internationally traded oil from all sources (including spot markets) was over $27 a barrel, about 108 percent above the level of December 1978.

Nevertheless, world economic growth was somewhat higher than had been anticipated at the beginning of the fiscal year. In part, this higher growth rate appears to have reflected expectation of higher rates of inflation. Rates of saving generally declined. Strong expansion of the German and Japanese domestic economies helped to maintain the average rate of growth in industrial countries other than the United States at about 4 percent. In the non-oil-exporting less developed countries (LDC's), the average rate of real economic growth continued in the 5-percent-a-year range.

In fiscal 1979 the industrial countries generally recognized that inflation was the most serious problem they faced. Increases in the cost of living in the developed countries accelerated sharply during the second half of the fiscal year, spurred by energy price increases and by spreading public expectations of higher wages and prices. Consumers and investors throughout the world demonstrated less confidence in the basic ability of governments to control inflation.

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Rates of inflation advanced sharply in all major industrial countries except Japan. In Germany and Switzerland, the rise in consumer prices from September 1978 to September 1979 reached about 5 percent, as compared with 1 to 2½ percent between September 1977 and September 1978. The dampening of inflation by exchange rate appreciation, which had held down the German and Swiss inflation rates during fiscal 1978, was not present in fiscal 1979. In addition, the cost of imported oil rose more sharply. Even with higher inflation rates in Germany and Switzerland, there remained important divergences in the inflation rates among the major industrial countries. In September 1979, consumer price indices showed advances of 3 to 5 percent over September 1978 in Japan, Germany, and Switzerland, while the corresponding figures for France, Italy, and the United Kingdom ranged from 11 to 16½ percent. In the United States the advance was about 12 percent, as compared with 8.3 percent a year earlier. In Canada the corresponding figures were about 9½ percent in both 1978 and 1979.

In fiscal 1979 the President and the Secretary of the Treasury made clear that the overriding objective of the U.S. economic policy would be to reduce inflation. The administration and the Federal Reserve System pursued an integrated set of policies aimed at the fundamental causes of inflation. Fiscal restraint was applied, reducing the Federal deficit from about 4 percent of the gross national product in fiscal 1976 to about 1 percent in 1979. In the monetary sphere, credit was tightened. As a result, short-term interest rates moved upward sharply during the fiscal year with 3-month Treasury bill issues yielding an average of 10.18 percent in September 1979, as against 7.84 percent in September 1978.

The growth in monetary aggregates slowed down markedly in January–June 1979, but turned upward again in the July–September period. This reversal led the Federal Reserve, in the week following the close of the fiscal year, to take new actions designed to assure "better control over the expansion of money and bank credit, help curb speculative excesses in financial, foreign exchange, and commodity markets and thereby serve to dampen inflationary forces." Greater emphasis was placed on the objective of containing the growth of the monetary aggregates within the desired ranges and with less emphasis on confining short-term fluctuations in the Federal funds rate. These measures, which included a further rise in the discount rate to 12 percent and some special reserve requirements, were well received in the international money and exchange markets as indicators of a firm resolve to apply strong credit restraint to reduce inflationary expectations.

A voluntary program to moderate pay and price increases was introduced in October 1978 which helped to gain time for other policies to take hold. Intensified attention was devoted to the costs of unnecessary Federal regulation of business activity. The series of measures taken on November 1, 1978, to stop a decline in the exchange rate for the dollar removed inflationary influences on the domestic economy which were being exerted by dollar depreciation.

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The administration gave high priority to the development of a national energy program to reduce our dependence on imported oil. Major measures adopted during the fiscal year included the President's decisions to begin progressive decontrol of crude oil prices, to limit U.S. oil imports to an amount below 1977 levels, and enactment of the five-part National Energy Act to increase energy supplies and reduce demand through measures which included gradual decontrol of natural gas prices. Other measures under consideration in Congress at the end of the fiscal year were a windfall profits tax, the Energy Security Corporation, and the Energy Mobilization Board. Specific programs called for fuel conversion by utilities from oil to coal, energy conservation incentives for families and businesses, improvement of the Nation's mass transportation system, and increased automobile fleet fuel efficiency.

Oil consumption in the United States declined progressively during fiscal 1979 resulting in fourth-quarter consumption more than 4 percent lower than during the corresponding period in fiscal 1978.

The oil price increases that took place in 1979, most of which occurred during the first half of the calendar year, have had a strong effect on international payments patterns. Estimates are not available for the U.S. fiscal year, but the members of the Organization of Petroleum Exporting Countries (OPEC) collectively are estimated to have had a current account surplus of more than $65 billion in calendar 1979 as compared with near balance in 1978. Most of this change affected the member countries of the Organization for Economic Cooperation and Development (OECD) whose balances shifted by an estimated $40 billion from an aggregate current account surplus of about $10 billion in calendar 1978 to a deficit of about $30 billion in 1979. The deterioration in the position of non-OPEC developing countries was probably more than $10 billion, leading to an aggregate deficit of about $35 billion (about $50 billion before taking account of official grants). The bulk of this deficit was experienced by the more advanced developing countries which were able to obtain financing from foreign private capital markets.

Although most of the deterioration in the position of the non-oil-exporting developing countries was accounted for by a few relatively advanced developing countries, the fact that all of the developing countries have been and will be paying higher prices for oil is likely to affect their ability to purchase other consumer goods and to finance development without adversely affecting their future debt service capacity.

The impact of this severe and abrupt deterioration in the current account position of oil-importing countries as a group was, however, mitigated by the fact that the pattern of individual current account positions among the major industrial countries became much better balanced. Despite an increase of $17 billion in oil imports, the U.S. current account was in approximate balance in calendar 1979 following a $131/2 billion deficit in calendar 1978. Japan's 1978 surplus of $16 billion was replaced by a deficit of nearly $9 billion in 1979. Germany had a current account deficit of about $4 billion in calendar 1979 in contrast to a surplus of about $8 billion in 1978. This more balanced position

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among the major countries was a significant factor in the maintenance of better exchange market stability.

Foreign Exchange and Gold Market Developments

Exchange market conditions reflected the contrasting developments in the world economy. The narrowing divergence in real growth rates and current account imbalances, coupled with the actions taken by the U.S. authorities in November 1978, were successful in bringing a halt to the exchange market disorders in the first quarter of fiscal 1979. The Federal Reserve further tightened monetary policy; the Treasury and the Federal Reserve announced their intent to mobilize up to $30 billion of foreign currencies to finance U.S. participation in coordinated market intervention with other major countries; and the Treasury increased its monthly sales of gold. These developments and policy measures provided a basis for more stable conditions and for a considerable appreciation of the dollar into the January–March quarter. However, the shift in market attention to the performance of the major countries in their efforts to reduce inflationary pressures began to be reflected in renewed tensions, first in the commodity markets and later in the foreign exchange markets. The prices of gold and other commodities began to rise steeply in the January–March quarter and continued to accelerate into the summer. The sharp increases in oil prices added to these tensions, generating further upward pressures on commodity prices and contributing to further strains in the exchange markets.

In September 1979, the European Monetary System underwent a realignment of rates, selling pressure on the dollar mounted, and the Japanese yen depreciated sharply in terms of all currencies. Credit conditions in all countries tightened quickly to address the resurgence in price pressures. Shortly after the end of the fiscal year on October 6, the United States announced: (1) A further 1-percentage-point increase in the discount rate to 12 percent, as compared with 8 percent at the beginning of the fiscal year, and (2) a shift in credit policy designed to restrict more effectively the rate of growth in the money supply. These actions, as well as similar moves in other countries, were effective in restoring more orderly conditions in the markets.

Overall, greater stability prevailed in exchange market conditions over the course of the fiscal year than in the previous fiscal year. On an average trade-weighted basis in terms of OECD currencies, the dollar experienced a negligible depreciation over the 12 months ending September 30, 1979, as compared with a 9.1-percent depreciation in the preceding 12-month period. The German mark appreciated 3.3 percent on a trade-weighted basis vis-a-vis other OECD currencies during the first quarter of the fiscal year. Further changes were minor. The greatest change, on this average basis, was seen in the Japanese yen, which depreciated by 18.1 percent over fiscal 1979 following a 31.6-percent appreciation in the previous fiscal year.

The greater stability in the value of the dollar and major European currencies was accompanied by a continuing rise in the aggregate reserves of

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foreign exchange reported by countries to the International Monetary Fund from $260 billion in September 1978 to $315 billion at the end of September 1979. This 20-percent growth was about the same rate of growth as in the previous fiscal year. The additions to reserves resulted in large part from official intervention and from official borrowing to add to reserves. Both industrial and developing countries increased their reserves. Those of the oil-exporting countries rose only by about 10 percent during this period.

The Treasury gold sales program was continued in fiscal 1979 with the basic purpose of strengthening the U.S. balance of payments position and, thus, contributing to stability in the foreign exchange market. At the same time, these sales furthered progress towards gradual reduction in the monetary role of gold. Monthly sales were increased from 300,000 ounces to 750,000 ounces in November 1978 and to 1,500,000 ounces in December, before being reduced to 750,000 ounces per month in May 1979. During the fiscal year, the Treasury sold 21.3 million ounces, improving the U.S. trade position by approximately $4 billion and providing $3.5 billion in financing of the Federal budget deficit.

The gold price advanced from $217 per ounce to nearly $400 per ounce during fiscal 1979. This speculative increase in the gold price was a disturbing sign both of heightened inflation and inflationary expectations affecting currencies generally as well as a reflection of growing political uncertainties in the Middle East. These disturbances contributed to instability in other commodity markets and in the foreign exchange markets and added to inflationary pressures. Shortly after the close of the fiscal year, the Treasury announced a more flexible approach to conducting gold sales in order to help deter the disruptive speculation that has characterized the gold market. In contrast to the regular monthly sales that had been held until that time, future sales were to be subject to variations in the amounts and dates of offerings.

The International Monetary System and the International Monetary Fund (IMF)

A number of steps were taken during the year to (a) strengthen the international monetary system and the role of the special drawing right (SDR) over the longer term and (b) enhance the IMF's ability to meet members' temporary balance of payments financing needs and to promote payments adjustment.

The IMF Articles of Agreement established the objective of making the SDR the principal reserve asset in the international monetary system. In December 1978 the IMF Board of Governors adopted a resolution providing for new allocations of SDR 12 billion over the 3-year period 1979–81. The initial distribution of SDR 4 billion was completed in January 1979 and represented the first allocation of SDR's since the 1970–72 distribution of SDR 9.3 billion. The United States received SDR 874 million, bringing total U.S. allocations to SDR 3,168 million.

The IMF also acted to improve the financial characteristics and usability of the SDR. The SDR interest rate has been brought more in line with market

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rates in order to make the SDR more competitive with other reserve assets. The minimum level to which SDR holdings may fall (on a 5-year average basis) was reduced from 30 percent to 15 percent of net cumulative allocations. The types of SDR transactions authorized have been expanded to include settlement of financial obligations not involving currencies, as well as loans of SDR's and use of SDR's as collateral.

The IMF also began consideration of the establishment of a substitution account that would accept deposits of dollars (and perhaps of other currencies) in exchange for SDR-denominated claims under prescribed rules and conditions. As the fiscal year ended, the IMF Interim Committee of Governors concluded that a properly designed account could contribute to an improvement of the international monetary system and could constitute a step toward making the SDR the principal reserve asset in the system. The Committee noted a number of desirable features for such an account and requested that the Executive Board give priority attention to designing an account. The Board is to report progress to the next meeting of the Interim Committee in April 1980.

The Board of Governors concluded the seventh review of quotas in December 1978 and recommended a 50-percent increase in quotas. The new quotas are to come into effect by November 1980 provided members with 75 percent of the total voting power consent to the increases in their quotas by that time. Legislation authorizing an increase in the U.S. quota, pursuant to the general increase in quotas, will be submitted to Congress during fiscal 1980.

The IMF remained in a position to meet temporary official financing needs throughout the fiscal year although private sources provided the major part of the needed financing during this period. Drawings from the IMF during the fiscal year exceeded $5 billion, of which nearly $3 billion was drawn by the United States. Repayments totaled over $6.5 billion.

In February 1979 the Supplementary Financing Facility entered into operation, providing $10.1 billion in additional resources to the IMF to cover the period before the quota increase becomes effective and to provide supplementary resources for lending to those countries experiencing most severe financing needs. The compensatory financing facility was also liberalized in August 1979, enabling the IMF to provide increased financing for payments difficulties arising from export earnings shortfalls. The IMF's policies on conditionality were modified in March 1979 in order to reflect changes in the global economy and to provide greater encouragement to members to seek IMF asistance at an early date before financial problems become severe.

The Eurocurrency Market, Private Sector Lending, and OPEC Investment

Against a background of substantial increases in the flow of international credit through private banks, major countries, with strong U.S. support, agreed to undertake through central bank channels a review of issues relating

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to the volume of such lending, in particular the portion taking place through the Eurocurrency market.

"Recycling" of oil exporters' surpluses was not a central feature of international credit flows during fiscal 1979; indeed, the OPEC area was a net borrower during much of the year. However, toward the end of this period the large oil price increases restored the OPEC countries to their previous status as large net suppliers of funds to international banks.

Financial Relations With Non-OPEC Less Developed Countries

Despite the increase in the aggregate current account deficit of the non-OPEC LDC's during calendar 1979 by nearly 50 percent to approximately $35 billion (after counting official unrequited transfers), total official and private financial flows to non-OPEC LDC's continued in calendar 1979 to exceed the aggregate current account deficits. Thus preliminary estimates suggest a further $8 billion increase in the aggregate reserves of these countries in calendar 1979 to a level of $74 billion following an increase of almost 30 percent in calendar 1978.

In 1979 the multilateral development banks (MDB's) were at the forefront of the international development effort. The World Bank group and the regional development banks made loan commitments of more than $13 billion to recipient countries in fiscal 1979. Disbursements of World Bank loans now constitute a very large percentage of official development assistance.

Although other countries contribute 75 percent of MDB resources, the United States has an influential role in determining the policies and practices of the MDB's. The United States, working through both the Secretary of the Treasury, who serves as U.S. Governor, and the U.S. Executive Director, who obtains his advice from the Treasury, has used this influence to increase the effectiveness of MDB lending. The United States, for example, played a leading role in supporting and encouraging adjustments in MDB lending policies which would ensure a greater participation of the poor in the benefits of growth. All of the banks in the last few years have changed the sectoral composition of their lending to favor projects which directly meet the needs of the poor. The United States has also encouraged the MDB's to adapt their lending policies to reflect both the growing diversity among recipient countries and changing world economic circumstances. In this context, the United States took the lead in encouraging the World Bank to help to expand and diversify sources of energy in the non-oil-exporting LDC's and to increase its role as a financial catalyst through cofinancing and guarantees.

The U.S. position on human rights in the MDB's is part of its overall policy to enhance the observance of human rights. Consistent both with existing legislation and administration policy, the U.S. Executive Directors to the MDB's are required to register opposition to projects for countries which are serious human rights violators unless such assistance serves the basic human needs of the citizens of the country.

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The United States recognizes the importance of assuring that the MDB's have the financial resources adequate to continue and, where possible, expand their vital role in the development process. During fiscal 1979 the United States participated in negotiations leading to agreements on replenishment of the resources of the Inter-American Development Bank, the African Development Fund, and the Asian Development Fund. It also participated in negotiations, not completed until the end of the calendar year, for the sixth replenishment for the World Bank group's concessional loan institution, the International Development Association. The United States also supported a proposal for a general capital increase for the World Bank group's nonconcessional loan institution, the International Bank for Reconstruction and Development.

In fiscal 1979, legislation was introduced in Congress to authorize U.S. participation in replenishments and increases in resources for the Inter-American Development Bank, the Asian Development Fund, and the African Development Fund. The total amount being requested for these three regional institutions was $4,019 million and covered U.S. subscriptions and contributions to be made over a 3- to 4- year period beginning in fiscal 1980. At the end of fiscal 1979, legislation to appropriate fiscal 1980 funding for U.S. participation in the MDB's was also awaiting final congressional approval.

The Treasury continues active participation in interagency formulation of U.S. development assistance policy through its chairmanship of the National Advisory Council on International Monetary and Financial Policies and its membership in the Development Coordination Committee and in various other interagency committees designed to coordinate economic assistance programs.

Treasury also continued to monitor closely developments regarding international indebtedness. During fiscal 1979, the U.S. Government participated in multilateral debt-rescheduling arrangements for Peru, Togo, and Turkey. Similar arrangements involving the United States were negotiated with Sudan in November 1979 and with Zaire in December 1979.

Trade and Investment

Fiscal 1979 saw the conclusion of the multilateral trade negotiations, normalization of economic relations with the People's Republic of China, more competitive financing of U.S. exports by the Export-Import Bank, and efforts to develop international understandings regarding investment policies. Treasury participated in the development of U.S. policy and in negotiations in each of these areas.

The successful conclusion of the multilateral trade negotiations, initiated in Tokyo in 1973, assures not only a substantial reduction in industrial tariffs, but also new codes governing the use of government subsidies, standards, procurement, licensing, and customs valuation which should significantly reduce these nontariff barriers to trade. The Trade Agreements Act of 1979,

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signed by President Carter in July 1979, makes the obligations contained in the MTN codes part of U.S. domestic law.

Of special interest to Treasury is the new code on subsidies and countervailing measures which will bring much-needed discipline to one of the most contentious areas of government intervention in trade. The code provides for explicit prohibitions on subsidies affecting industrial trade, for improved discipline over the use of agricultural export subsidies, and for more rapid dispute resolution procedures.

Following the establishment of diplomatic ties with the People's Republic of China in January 1979, Secretary Blumenthal was charged with the task of coordinating the normalization of U.S.-China economic relations. The Secretary led an official delegation to China in February which successfully negotiated a claims/assets agreement, established the U.S.-China Joint Economic Committee, and initiated discussions on a trade agreement and banking and finance matters. Treasury has actively participated in the subsequent negotiation of a trade agreement and in the formulation of U.S. Government policy on other bilateral economic issues, including maritime, civil aviation, and textile matters and the extension of Overseas Private Investment Corporation and Export-Import Bank programs for China. Secretary Miller succeeded Mr. Blumenthal as Co-chairman of the U.S.-China Joint Economic Committee, which will continue to address a wide range of bilateral trade, technological, investment, and financial matters.

Early in fiscal 1979, the Secretary and other Treasury officials sought to negotiate improvements which would strengthen the International Arrangement on Export Credits. It was not possible to achieve common agreement on these objectives among participants in the Arrangement. The U.S. Government therefore reexamined and modified its own policies to assure that the United States would remain competitive in the export credit area. The Export-Import Bank has become more aggressive in providing official support for U.S. exports by increasing its participation in project financing, providing competitive interest rates, and matching on a selective basis the mixed credits and local cost financing offered by other industrial exporting countries. The United States continues to adhere to the International Arrangement as a useful, though limited, first step toward international discipline in this area.

Treasury played a key part in formulating and developing U.S. initiatives to promote both international discussions on the use of governmental investment incentives and performance requirements as well as possible agreements to deal with them. At the suggestion of the United States, the OECD Committee on International Investment and Multinational Enterprises agreed to undertake a comprehensive examination of the effects of investment incentives and disincentives on international economic relations.

The IMF/IBRD Development Committee, formed in 1974 to maintain an overview of the development process especially regarding the transfer of resources to developing countries, established a Task Force on Private Foreign Investment chaired by the U.S. Assistant Secretary of the Treasury for

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International Affairs. The task force is examining home and host country policies affecting international investment, including incentives and performance requirements, and will make recommendations to the Committee.

Treasury also chaired the Committee on Foreign Investment in the United States, an interagency group which reviewed and coordinated general U.S. policy on foreign investment in this country. During the year, this Committee also dealt with the issues of purchases by foreigners of U.S. farmland, Renault's plans to invest in American Motors Corp., and other issues.

Commodities and Natural Resources

There is a general agreement among both producing and consuming countries that the most effective instruments for achieving greater commodity market stability are international commodity agreements (ICA's) utilizing buffer stock mechanisms, wherever feasible, as the vehicle for stabilizing price fluctuations. During fiscal 1979 the United States participated in the negotiation of rubber and cocoa agreements, and in October 1979 an accord was reached on an agreement for buffer stocking natural rubber. Operation of this agreement is expected to begin before the end of calendar 1980. Serious differences between exporters and importers on the price range caused a temporary recess in the cocoa discussions. International discussions on several other commodities—copper, cotton, jute, tea, tungsten—continued, but none of these has yet advanced to the stage of formal negotiation of agreements.

In addition, the framework for the negotiation of the final text of an agreement establishing a common fund to provide adequate financing of ICA's was achieved in March 1979. By pooling the financial resources of ICA's, the common fund can facilitate more efficient financing of individual commodity agreements and, thereby, lessen the budgetary outlays of member countries for these agreements.

The Conference on Law of the Sea made some progress in defining the international deep seabed mining arrangement although serious differences remained between industrialized and developing countries on the structure and functions of the arrangement's institutions. At issue are the terms and conditions under which individual private companies or national governments would be permitted to engage in mining activities in the international seabeds.

United States-Saudi Arabian Joint Commission on Economic Cooperation

Two developments in the energy field were of particular significance in the operation of the United States-Saudi Arabian Joint Commission during fiscal 1979. The first was the completion of a comprehensive 25-year electrification plan for Saudi Arabia. The second was identification of the site, within Saudi Arabia, for the world's largest solar-powered electrical generating station. The initial phase of the power station is scheduled to be in operation by mid-1980. The $15 million solar village project is the first in a series of projects to be implemented under a 5-year, $100 million joint United States-Saudi solar program. During the fiscal year, 19 projects in various fields were underway.

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REVIEW OF TREASURY OPERATIONS

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FINANCIAL OPERATIONS

Summary

On the unified budget basis the deficit for fiscal 1979 was $27.3 billion. Net receipts for fiscal 1979 amounted to $465.9 billion ($63.9 billion over fiscal 1978), and outlays totaled $493.2 billion ($42.3 billion over fiscal 1978).

Fiscal 1979 borrowing from the public amounted to $33.6 billion as a result of (1) the $27.3 billion deficit, (2) a $0.4 billion increase in cash and monetary assets, and (3) a $6.0 billion decrease in other means of financing.

As of September 30, 1979, Federal securities outstanding totaled $833.8 billion, comprised of $826.5 billion in public debt securities and $7.2 billion in agency securities. Of the $833.8 billion, $644.6 billion represented borrowing from the public.

The Government's fiscal operations for 1978 and 1979 are summarized as follows:

[In billions of dollars]

	1978	1979
Budget receipts and outlays:		
Receipts	402.0	465.9
Outlays	450.9	493.2
Budget deficit	-48.9	[1]-27.3
Means of financing:		
Borrowing from the public	59.1	33.6
Increase in cash and other monetary assets	-3.0	-.4
Other means:		
Increment on gold and seigniorage	.3	1.0
Profit on sale of gold	.2	2.4
Outlays of off-budget Federal agencies	-10.3	-12.4
Other	2.6	3.1
Total budget financing	48.9	27.3

[1] The joint Treasury-Office of Management and Budget press statement, released with the September 1979 Monthly Treasury Statement, adjusted this total to include administrative expenses and interest receipts of the Exchange Stabilization Fund. The total in the press release is $27.7 billion for the deficit.

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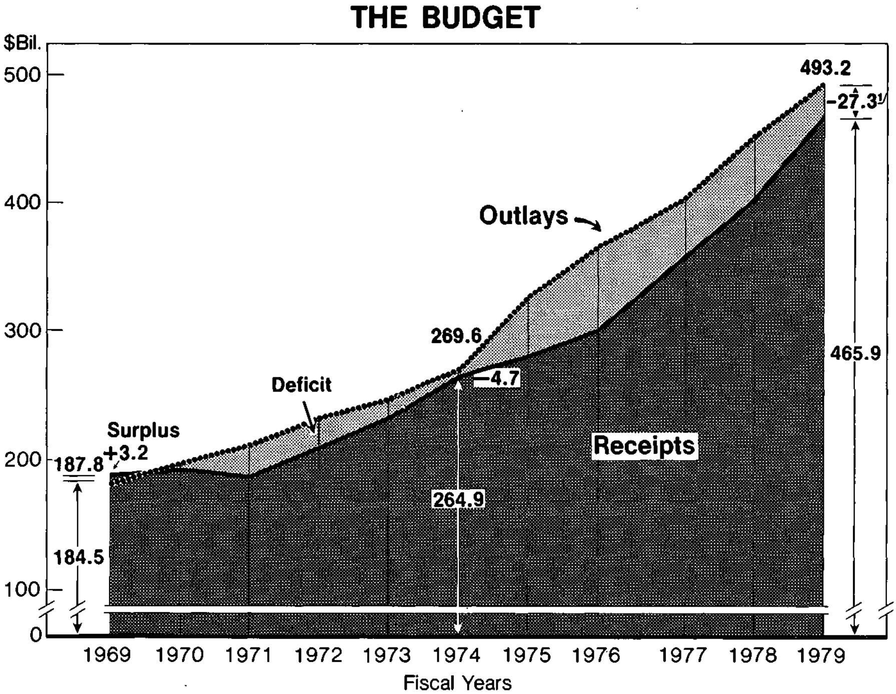

1/ The joint Treasury-Office of Management and Budget press statement, released with the September 1979 Monthly Treasury Statement, adjusted this total to include administrative expenses and interest receipts of the Exchange Stabilization Fund. The total in the press release is $27.7 billion for the deficit.

Receipts

Total budget receipts amounted to $465.9 billion in fiscal 1979, an increase of $63.9 billion over fiscal 1978. Net budget receipts by major source for fiscal years 1978 and 1979 are shown below.

[In millions of dollars]

Source	1978	1979
Individual income taxes	180,988	217,841
Corporation income taxes	59,952	65,677
Employment taxes and contributions	103,893	120,074
Unemployment insurance	13,850	15,387
Contributions for other insurance and retirement	5,668	6,130
Excise taxes	18,376	18,745
Estate and gift taxes	5,285	5,411
Customs duties	6,573	7,439
Miscellaneous receipts	7,413	9,237
Total budget receipts	401,997	465,940

Projected estimates of receipts to future years, required of the Secretary of the Treasury, are shown and explained in the President's budget.

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Individual income taxes.—Individual income taxes rose to $217.8 billion in fiscal 1979, an increase of $36.9 billion. Substantially all of the increase was due to higher personal incomes and continued inflation that raised individuals to higher tax brackets.

Corporation income taxes.—Corporation income taxes increased by $5.7 billion over the prior year. This modest increase (just under 10 percent) reflects in part unusually high final payments in fiscal 1978.

Employment taxes and contributions.—Receipts from this source totaled $120.1 billion, mainly resulting from an increase in the social security taxable earnings base to $22,900, effective January 1, 1979, as well as an increase in the tax rate.

Unemployment insurance.—Unemployment insurance receipts increased by 11 percent to reach $15.4 billion in fiscal 1979. State tax deposits at the Treasury, the largest component in this category, increased by $1.2 billion, reflecting continued high financing of past unemployment benefits. In addition, the Federal Unemployment Tax Act base was raised from $4,200 to $6,000 effective January 1, 1978, and receipts from this source increased from $2.6 billion in fiscal 1978 to $2.9 billion in fiscal 1979, a 12-percent increase.

Contributions for other insurance and retirement.—Receipts in this category increased by $0.5 billion to a total of $6.1 billion in fiscal 1979.

Excise taxes.—Receipts of excise taxes in fiscal 1979 were $18.7 billion, an increase of $0.4 billion over the prior year. These receipts reflect continued phaseout of the telephone excise tax from 4 percent in 1978 to 3 percent in 1979.

Estate and gift taxes.—Receipts in this category increased by $0.1 billion in fiscal 1979 to reach $5.4 billion.

Customs duties.—Customs duties increased by $0.9 billion in fiscal 1979 to reach $7.4 billion.

Miscellaneous receipts.—These receipts totaled $9.2 billion in fiscal 1979, an increase of $1.8 billion. Deposits by the Federal Reserve System, the largest component of this category, increased by $1.7 billion to reach $8.3 billion.

Outlays

Total outlays in fiscal 1979 were $493.2 billion (compared with $450.9 billion for 1978). Outlays by major agency for fiscal years 1978 and 1979 are presented in the following table. For details see the Statistical Appendix.

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[In millions of dollars]

	1978	1979
Funds appropriated to the President	4,459	2,537
Agriculture Department	20,368	20,634
Defense Department	105,595	117,921
Energy Department	6,264	7,889
Health, Education, and Welfare Department	162,856	181,186
Housing and Urban Development Department	7,597	9,218
Labor Department	22,951	22,650
Transportation Department	13,452	15,486
Treasury Department	56,457	64,596
National Aeronautics and Space Administration	3,980	4,187
Veterans Administration	18,962	19,887
Other	43,769	45,521
Undistributed offsetting receipts	-15,772	-18,489
Total outlays	450,938	493,221

Cash and monetary assets

On September 30, 1979, cash and monetary assets amounted to $32.1 billion. The balance consisted of U.S. Treasury operating cash of $24.2 billion ($1.7 billion more than September 30, 1978); $0.9 billion held in special drawing rights ($0.7 billion less than September 30, 1978); a net $1.3 billion with the International Monetary Fund ($2.2 billion less than September 30, 1978); and $5.7 billion of other cash and monetary assets ($2.1 billion more than September 30, 1978).

For a discussion of the assets and liabilities in the Treasury's account, see page 151. Transactions affecting the account in fiscal 1979 are shown in the following table:

Transactions affecting the account of the U.S. Treasury, fiscal 1979
[In millions of dollars]

Operating balance Sept. 30, 1978			22,444
Excess of deposits or withdrawals (-), budget, trust, and other accounts:			
Deposits		536,647	
Withdrawals (-)		549,255	-12,608
Excess of deposits or withdrawals (-), public debt accounts:			
Increase in gross public debt		54,975	
Deduct:			
Net discounts on new issues	15,644		
Interest increment on savings and retirement plan securities	4,349		
Net public debt transactions included in budget, trust, and other Government accounts	20,645		
Net deductions		40,638	14,337
Operating balance Sept. 30, 1979			24,176

Corporations and other business-type activities of the Federal Government

The business-type programs which Government corporations and agencies administer are financed by appropriations (made available directly or in exchange for capital stock), borrowings from either the U.S. Treasury or the public, or by revenues derived from their own operations. Various agencies have been borrowing from the Federal Financing Bank, which began operations in May 1974. The bank is authorized to purchase and sell securities

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issued, sold, or guaranteed by Federal agencies. Many Federal agencies finance programs through this bank that would otherwise involve the sale or issuance of credit market instruments, including agency securities, guaranteed obligations, participation agreements, and sales of assets.

Corporations or agencies having legislative authority to borrow from the Treasury issue their formal securities to the Secretary of the Treasury. Outstanding borrowings are reported as liabilities in the periodic financial statements of the Government corporations and agencies. In fiscal 1979 borrowings from the Treasury, exclusive of refinancing transactions, totaled $60.1 billion, repayments were $39.4 million, and outstanding loans on September 30, 1979, totaled $106.3 billion.

Agencies having legislative authority to borrow from the public must either consult with the Secretary of the Treasury regarding the proposed offering, or have the terms of the securities to be offered approved by the Secretary.

The Federal Financing Bank makes funds available in accordance with program requirements to agencies having authority to borrow from the bank, and, in recent years, has become a major source of funds for these agencies. Interest rates shall not be less than rates determined by the Secretary of the Treasury, taking into consideration current average yields on outstanding Government or bank securities of comparable maturity. The bank may charge fees to provide for expenses and reserves. During fiscal 1979, all funds loaned by the bank have been borrowed from the Treasury.

During fiscal 1979, Congress granted new authority to borrow from the Treasury in the total amount of $25.6 billion, adjustments increased borrowing authority by $1.0 billion, making a total increase of $26.5 billion. The status of borrowings and borrowing authority and the amount of corporation and agency securities outstanding as of September 30, 1979, are shown in the Statistical Appendix.

Unless otherwise specifically fixed by law, the Treasury determines interest rates on its loans to agencies by considering the Government's cost for its borrowings in the current market, as reflected by prevailing market yields on Government securities which have maturities comparable with the Treasury loans to the agencies. A description of the Federal agency securities held by the Treasury on September 30, 1979, is shown in the Statistical Appendix.

During fiscal 1979, the Treasury received $6.5 billion from agencies which consisted of dividends, interest, and similar payments. (See the Statistical Appendix.)

As required by Department Circular No. 966, Revised, semiannual statements of financial condition, and income and retained earnings are submitted to the Treasury by Government corporations and business-type agencies (all other activities report on an annual basis). Quarterly statements showing direct and guaranteed loans, and annual statements of commitments and contingencies are also submitted. These statements are the basis for the combined financial statements compiled by the Treasury which, together with individual statements, are published periodically in the Treasury

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Bulletin. Summary statements of the financial condition of Government corporations and other business-type activities, as of September 30, 1979, are shown in the Statistical Appendix.

Joint Financial Management Improvement Program

JFMIP worked on a number of studies aimed at improving financial management in the Federal Government. The study on auditing federally assisted programs was completed, and the final report recommended that the single audit approach be implemented. A checklist for agencies designing and implementing financial management systems was issued.

JFMIP updated and released a publication on financial management functions in the Federal Government. Another publication, the 30th anniversary annual report, highlighted the history and the progress made in financial management.

Projects that were initiated include the study of the roles and responsibilities of certifying officers, the development of a productivity measurement system for accounting and finance officers, and a review of agency financial management reports and their use.

JFMIP continued to sponsor letter-of-credit workshops in regional cities and conducted a cash management techniques workshop in Washington, D.C. The eighth annual Financial Management Conference was held on March 19, 1979, on "Rebuilding Public Confidence in Government—The Financial Manager's Role."

DOMESTIC FINANCE

Federal Debt Management

In fiscal 1979 the Treasury was required to finance a budget deficit of $27.3 billion and refund record amounts of maturing securities in an inflationary economic atmosphere with continuously rising prices and interest rates. While output and employment rose and unemployment fell, the year was marred by the serious acceleration in the rate of inflation and the decline in the value of the dollar in foreign exchange markets. Over the course of the fiscal year the Consumer Price Index accelerated from a 9-percent annual rate to more than 12 percent and interest rates moved up sharply to record levels, especially short rates. Rates on Treasury's 1-, 5-, 10-, and 20-year maturities increased approximately 220, 100, 90, and 75 basis points, respectively. The rate on 3-month bills rose over 240 basis points while the prime rate was increased 16 times ranging from 9¾ percent at the start of the fiscal year to 13½ percent at the end.

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Federal debt and Government-sponsored agency debt
[In billions of dollars]

	Sept. 30, 1977	Sept. 30, 1978	Sept. 30, 1979	Increase or decrease
Public debt securities:				
Marketable public issues by maturity class:				
Within 1 year	217.9	225.4	246.7	21.3
1 to 5 years	148.4	168.5	157.3	-11.2
5 to 20 years	58.9	65.9	71.7	5.9
Over 20 years	18.3	25.4	30.9	5.5
Total marketable issues	443.5	485.2	506.7	21.6
Nonmarketable public issues:				
Series E and H savings bonds	75.4	79.8	80.4	.6
U.S. savings notes[1]	.4	.4	.4	—
Investment series bonds	2.2	2.2	2.2	—
Foreign government series:				
Dollar denominated	20.5	20.9	24.0	3.1
Foreign currency denominated	1.3	.8	4.2	3.4
State and local government series	11.4	24.2	24.6	.3
Other nonmarketable debt	2.8	.1	.1	—
Total nonmarketable public issues	114.0	128.4	136.0	7.4
Government account series (nonmarketable)	140.1	153.3	176.3	23.1
Non-interest-bearing debt	1.2	4.6	7.5	2.9
Total gross public debt	698.8	771.5	826.5	54.9
Federal agency securities:				
Gov't National Mortgage Association	3.8	3.2	3.0	-.2
Export-Import Bank of the United States	2.9	2.1	.9	-1.2
Tennessee Valley Authority	1.8	1.8	1.7	-.1
Defense family housing	1.0	.9	.8	-.1
Other	.8	.9	.8	-.1
Total Federal agency debt	10.3	8.9	7.2	-1.6
Total Federal debt	709.1	780.4	833.8	53.3
Government-sponsored agency securities:				
Federal home loan banks	19.2	27.4	45.5	18.1
Federal National Mortgage Association	31.5	38.4	46.4	8.0
Federal land banks	18.7	20.2	17.1	-3.1
Federal intermediate credit banks	11.7	11.6	2.7	-8.9
Banks for cooperatives	4.1	4.3	.8	-3.5
Farm Credit discount notes	1.0	2.8	3.4	.6
Farm Credit consolidated bonds	1.0	2.3	25.9	23.6
Government-sponsored agency debt	87.2	107.0	141.7	34.7

[1] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.

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The Treasury avoided adding to money market pressures, and to excessive liquidity in the economy, by continuing its policy of debt extension and thus financing the budget deficit with longer term coupon securities, rather than short-term bills. Moreover, to deal with exchange market pressures on the dollar, the Treasury embarked on a program to issue up to $10 billion in securities denominated in foreign currencies to use in its exchange market operations.

The record amount of $53.9 billion of privately held coupon securities to be refunded in the market, compared with $48.1 billion in fiscal 1978 and $35.4 billion in 1977, was due primarily to the buildup of regularized 2-year cycle notes and quarterly 4-year cycle notes, which began to mature concurrently in December 1978, amounting to $31.3 billion for the fiscal year. Despite this larger amount of cycle notes that had to be refunded, the Treasury was still able to accomplish further debt extension, primarily through continued and enlarged offerings of long-term bonds in the midquarterly refundings as well as regular quarterly offerings of 15-year bonds. These longer term security offerings contributed to a more balanced maturity structure of the debt and will help to facilitate efficient debt management in the future. In addition, these offerings complemented the administration's program to restrain inflation. By meeting its new cash requirements in the note and bond market, rather than the bill market, the Treasury avoided adding to the liquidity of the economy at a time when excessive liquidity was being transmitted into increasing prices. By the end of the fiscal year the Treasury had increased the average length of the privately held marketable debt by 4 months to 3 years 7 months.

For the fiscal year, total Treasury financing, excluding Treasury bills, amounted to $86.7 billion, of which $53.9 billion was to refund maturing securities privately held and $11.1 billion was allotted to Federal Reserve banks and Government accounts in exchange for their holdings of maturing issues. Total new cash raised from marketable and nonmarketable issues amounted to $35.6 billion for the fiscal year, compared with $63 billion in fiscal 1978 and $53 billion in fiscal 1977. Nonmarketable issues provided $8.3 billion of the total $35.6 billion of new cash while marketable securities, excluding the $28.5 billion of cash management bills issued and redeemed during the fiscal year, provided $0.3 billion from regular Treasury bills and $27 billion from notes and bonds. The new cash raised from notes and bonds consisted of $5.1 billion from 2-year cycle notes, $4.7 billion from 4-year cycle notes, $6 billion from 15-year bonds, $3 billion from long bonds, and $8.2 billion from intermediate notes.

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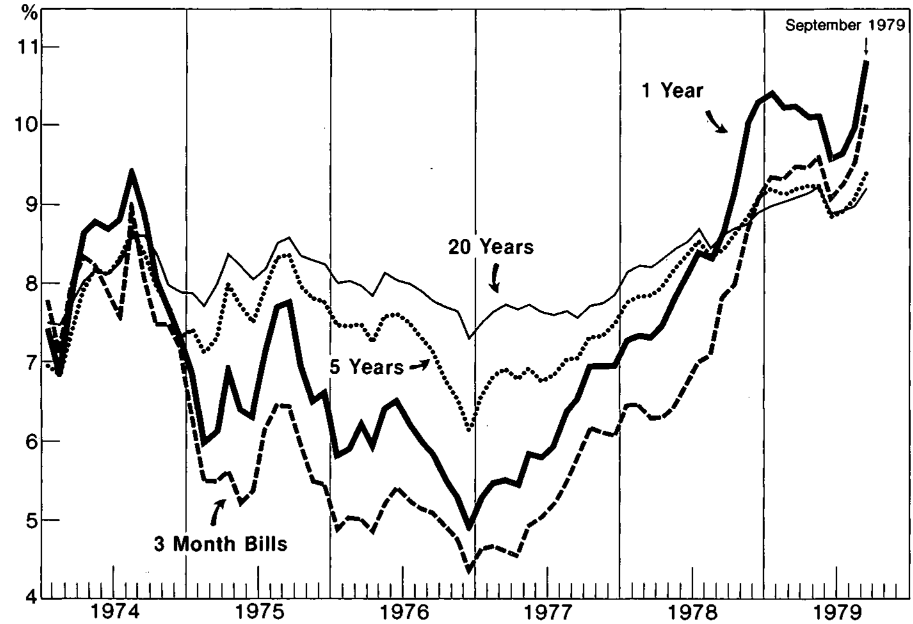
MARKET YIELDS AT CONSTANT MATURITIES 1974-1979[1]



[1]Monthly averages of daily market yields of public debt securities. Bank discount rates of Treasury bills.

Changes in Federal securities

Federal securities include Treasury marketable and nonmarketable issues as well as those obligations issued by Federal agencies which are included in the unified budget totals and in which there is an element of Federal ownership. The Federal agency securities included are the participation certificates of the Government National Mortgage Association, the debt issues of the Export-Import Bank of the United States and the Tennessee Valley Authority, Postal Service bonds, Defense family housing mortgages, and various guaranteed debentures of the Federal Housing Administration.

At the close of fiscal 1979, there were $833.8 billion of Federal securities outstanding, compared with $780.4 billion a year earlier. Outstanding public debt issues of the Treasury amounted to $826.5 billion, an increase of $55 billion for the fiscal year. Federal agency issues outstanding totaling $7.2 billion were down $1.6 billion from a year ago. Treasury marketable securities outstanding at the end of fiscal 1979 amounted to $506.7 billion, an increase of $21.6 billion for the year, but $20.2 billion less than the increase in fiscal 1978.

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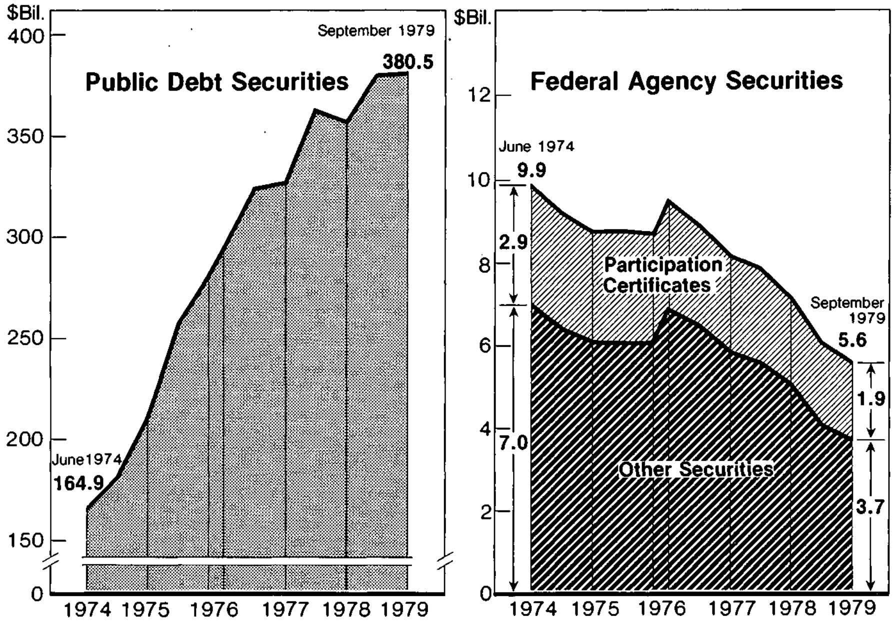
PRIVATE HOLDINGS OF MARKETABLE FEDERAL SECURITIES



Nonmarketable Treasury issues increased by $30.5 billion to a level of $312.3 billion at the end of fiscal 1979. The increase in nonmarketable issues was $2.8 billion more than the $27.7 billion increase in fiscal 1978. Nearly 76 percent of the fiscal 1979 increase in nonmarketables was in the special nonmarketables issued only to Government accounts and trust funds. These issues increased $23.1 billion, compared with $13.2 billion in fiscal 1978. In addition, special nonmarketables issued to foreign official accounts increased $6.4 billion in fiscal 1979, compared with a $0.1 billion decline last year, while special nonmarketable securities issued to State and local governments increased $0.3 billion, compared with $12.8 billion in fiscal 1978. An increase of $0.6 billion in savings bonds was considerably below the $4.4 billion increase in fiscal 1978.

Federal securities do not include the securities issued by Government-sponsored agencies since these agencies are not owned in whole or in part by the Government, although they are subject to some degree of Federal supervision. In fiscal 1979, the debt of Government-sponsored agencies increased by $34.7 billion to a level of $141.7 billion. The Farm Credit System's consolidated bonds and discount notes increased $24.1 billion and Federal home loan banks issues rose $18.1 billion. Securities issued by the Federal National Mortgage Association increased $8 billion, while outstanding issues of the Federal intermediate credit banks declined $8.9 billion. Banks

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for cooperatives issues fell $3.5 billion and Federal land banks issues decreased $3.1 billion. At the end of fiscal 1979 private investors held $132.9 billion of Government-sponsored agency securities.

Estimated ownership

Private investors held $529 billion of the $833.8 billion total of Federal securities outstanding at the end of fiscal 1979. Federal Reserve banks and Government accounts held the remaining $306.8 billion. Borrowing from the public, which includes the Federal Reserve as well as private investors, amounted to a net $33.6 billion, compared with $59.1 billion in fiscal 1978. Private investors, including foreign and international investors, accounted for a $33.5 billion increase in Federal securities while the Federal Reserve banks showed a net decline of $0.6 billion.

Individuals.—Holdings of public debt securities by individuals increased $3.7 billion, compared with $5.6 billion in fiscal 1978. The smaller increase in fiscal 1979 was due mainly to the shortfall in the savings bonds program, which increased only $0.6 billion, compared with an increase of $4.4 billion in fiscal 1978. Holdings of other Treasury securities increased by $3.1 billion, however, compared with $1.2 billion in fiscal 1978. At the end of the fiscal year individuals held $113.2 billion of public debt securities, of which $80.6 billion were savings bonds and notes. Holdings of Federal agency securities amounting to $0.4 billion were about the same as at the end of fiscal 1978.

Insurance companies.—Public debt securities held by insurance companies declined $0.6 billion in fiscal 1979, compared with an increase of $0.8 billion a year earlier. At the end of fiscal 1979 insurance companies held $14.6 billion of public debt securities and $0.4 billion of Federal agency securities.

Savings and loan associations.—Savings and loan associations liquidated $1.3 billion of public debt securities and $0.1 billion of Federal agency securities in fiscal 1979, compared with a drop of $1.5 billion of public debt securities and a $0.2 billion increase in holdings of agency securities in fiscal 1978. Holdings at the end of the fiscal year amounted to $7 billion of public debt issues and $0.3 billion of Federal agency securities.

Mutual savings banks.—Mutual savings banks also reduced their holdings of public debt securities and Federal agency issues. They dropped $0.5 billion of public debt securities and $0.2 billion of agency issues. This brought their holdings at the end of the fiscal year to $4.7 billion of public debt securities and $0.6 billion of Federal agency securities.

State and local governments.—Public debt securities held by State and local governments at the end of fiscal 1979 amounted to $68.9 billion, which was little changed from fiscal 1978 as a $0.4 billion decline in State and local special nonmarketable issues was offset by a similar increase in holdings of marketables. The decline in special nonmarketables issued to State and local units compared with a $12.8 billion increase in fiscal 1978. State and local governments invested substantial amounts of their advance refunding proceeds prior to the September 1, 1978, deadline when new Treasury

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Estimated ownership of public debt securities on selected dates 1977–79
[Dollar amounts in billions]

	Sept. 30, 1977	Sept. 30, 1978	Sept. 30, 1979	Change during fiscal 1979
Estimated ownership by:				
Private nonbank investors:				
Individuals:[1]				
Series E and H savings bonds	$75.2	$79.5	$80.2	0.6
U.S. savings notes[2]	.4	.4	.4	(*)
Other securities	28.3	r29.5	32.6	3.1
Total individuals	103.9	r109.4	113.2	3.7
Insurance companies	14.3	15.1	14.6	-.5
Mutual savings banks	6.2	r5.2	4.7	-.5
Savings and loan associations	9.7	r8.3	7.0	-1.3
State and local governments	53.0	r68.9	68.9	(*)
Foreign and international	95.5	121.0	125.2	4.3
Corporations	23.3	r21.3	23.7	2.4
Miscellaneous investors[3]	32.9	r42.8	73.7	30.9
Total private nonbank investors	338.8	r392.0	431.1	39.1
Commercial banks	99.8	r96.2	92.3	-4.0
Federal Reserve banks	104.7	115.3	115.5	.2
Government accounts	155.5	168.0	187.7	19.7
Total gross debt outstanding	698.8	771.5	826.5	55.0
Percent owned by:				
Individuals	15	14	14	
Foreign and international	14	16	15	
Other private nonbank investors	20	21	23	
Commercial banks	14	12	11	
Federal Reserve banks	15	15	14	
Government accounts	22	22	23	
Total gross debt outstanding	100	100	100	

r Revised.
* Less than $50 million.
[1] Including partnerships and personal trust accounts.
[2] U.S. savings notes first offered in May 1967; sales discontinued after June 30, 1970.
[3] Includes nonprofit institutions, corporate pension trust funds, nonbank Government security dealers, certain Government deposit accounts, Government-sponsored agencies, and other investor groups not shown above.

regulations restricting arbitrage opportunities went into effect. Holdings of Federal agency issues declined by $0.2 billion to a level of $1.9 billion.

Foreign and international.—Foreign investors increased their holdings of public debt securities $4.3 billion in fiscal 1979, compared with the record $25.4 billion increase in fiscal 1978. Foreign holdings were very volatile during the fiscal year, increasing by $21.3 billion in the first 4 months, then declining by $24.3 billion in the next 4 months, and finally increasing by $7.2 billion in the final 4 months to a level of $125.2 billion at the end of the fiscal year. For the year as a whole, special nonmarketables increased $7.4 billion and marketables decreased by $3.1 billion. Most of the increase in nonmarketables resulted from the $4.2 billion of special foreign currency public issues to residents of Germany and Switzerland in connection with the dollar support

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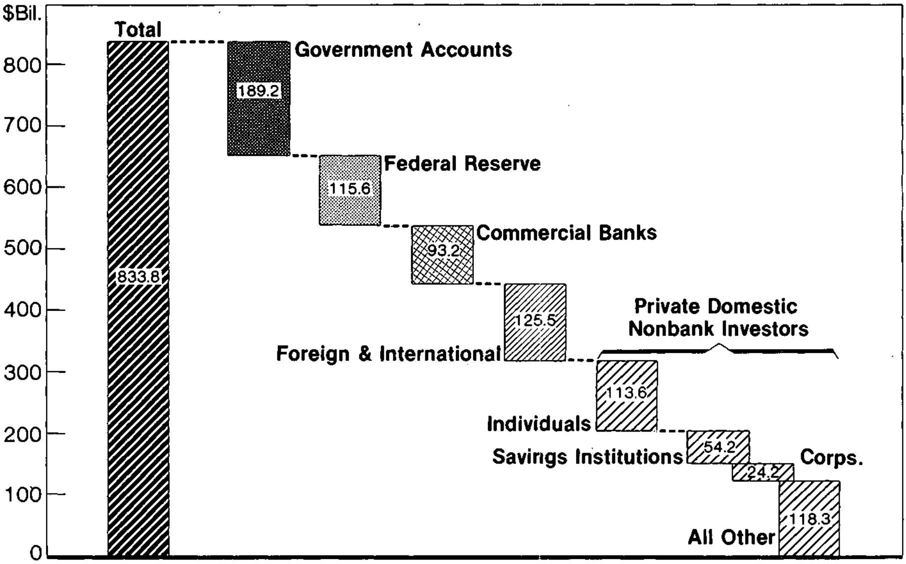
program announced by the President on November 1. Federal agency securities held by foreign investors declined by $0.1 billion to a level of $0.3 billion at the end of fiscal 1979.

OWNERSHIP OF FEDERAL SECURITIES

September 30, 1979



Nonfinancial corporations.—Corporations increased their holdings of public debt securities $2.4 billion after liquidating $2 billion in each of the 2 past fiscal years. At the end of September 1979 they held $23.7 billion of public debt securities. Holdings of Federal agency issues increased $0.1 billion for the year to a level of $0.5 billion.

Other private nonbank investors.—Holdings of other private nonbank investors increased by nearly $31 billion in fiscal 1979, or nearly three times the increase in fiscal 1978. Holdings of Federal agency securities declined $0.2 billion to an end of fiscal year level of $0.5 billion.

Commercial banks.—Public debt securities held by commercial banks declined $4 billion as banks continued to liquidate public debt securities to help finance their booming loan demand from business and consumers. The decline in fiscal 1979 was just $0.5 billion less than in fiscal 1978. At the end of fiscal 1979 banks held $92.3 billion of public debt securities. Holdings of Federal agency issues declined $0.5 billion to a level of $0.9 billion at the end of the year.

Federal Reserve System.—The Federal Reserve System's holdings of public debt securities increased by $0.2 billion as the System pursued a tightened monetary policy in order to strengthen the international position of the dollar and to slow the growth of the money supply. By contrast, in fiscal 1978

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holdings increased by $10.6 billion and in fiscal 1977 by $8.3 billion. At the end of fiscal 1979 the System held $115.5 billion of public debt securities and $0.1 billion of Federal agency securities.

Government accounts.—Public debt securities held by Government accounts increased $19.7 billion in fiscal 1979, compared with increases of $12.5 billion in fiscal 1978 and $9.4 billion in fiscal 1977. Special nonmarketable securities held by these accounts accounted for the increase as holdings of marketable securities fell by $2.5 billion. Federal agency securities held by Government accounts declined $0.1 billion. At the end of the fiscal year Government accounts held $187.7 billion of public debt securities and $1.5 billion of Federal agency securities.

Market financing operations

October–December 1978.—The Treasury had a comfortable cash balance of $22.4 billion at the start of fiscal 1979, so there was no immediate need to raise new cash. The first security to be refunded in the new fiscal year was the $2.7 billion maturing 2-year note to be auctioned on September 20, with the payment date of October 2, 1979. This auction had been announced on September 13, 1979. The auction was well received and attracted $5,195 million of tenders from the public including $595 million of noncompetitive tenders and $670 million of add-ons from foreign investors. Commercial banks received $1.3 billion, or 38 percent, of the notes. The average auction yield was 8.65 percent and the coupon was set at 8⅝ percent on this issue.

On September 19, the Treasury announced it would sell $1.5 billion of 15-year 1-month bonds to raise new cash. The bonds were to be dated October 10. The September 27 auction drew $2.5 billion of tenders, of which $152 million of noncompetitive tenders were accepted along with $1,352 million of competitive tenders. Commercial banks took $0.5 billion, or 32 percent, of the issue while dealers took $0.6 billion, or 40 percent. The resulting average auction yield was 8.64 percent and an 8⅝-percent interest rate was assigned to the bonds.

An auction of $3.3 billion of 2-year notes was announced on October 17 to refund $2.7 billion of notes due October 31 and to raise $0.5 billion of new cash. Of the $4,152 million of tenders received $3,252 million was accepted. Accepted tenders included $526 million of noncompetitive tenders, $2,526 million of competitive tenders from private investors, and $300 million of foreign add-ons. The resulting issue size was $3.6 billion. The average auction yield was 8.94 percent and the interest rate was set at 8⅞ percent. Commercial banks received $1.6 billion, or 45 percent, of the notes and dealers received $0.9 billion, or 26 percent.

The Treasury announced a quarterly refunding package totaling $6.8 billion on October 25. The three new securities were: $2.5 billion of 3½-year notes, $2.5 billion of 10-year notes, and $1.8 billion of 30-year bonds. The new securities were auctioned to raise $2.2 billion of new cash and refund $4.9 billion of privately held securities maturing November 15.

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Auctioned October 31, the 3½-year notes received a good deal of attention. Of the $7,032 million of tenders submitted, $2,512 million was accepted including $1,099 million of noncompetitive tenders and $1,113 million of competitive tenders from private investors. The average yield of 9.36 percent led to an assigned interest rate of 9¼ percent. Commercial banks took $1.2 billion, or 45 percent, of the notes and dealers received $0.5 billion, or 18 percent.

The 10-year notes did not attract quite as much attention. The November 2 auction received $3,162 million of tenders and $2,501 million was accepted. Noncompetitive tenders amounted to $303 million and accepted competitive tenders came to $2,198 million. An 8¾-percent interest rate was set after an average yield of 8.85 percent was calculated. Dealers received $0.5 billion, or 18 percent, of the issue; commercial banks were allotted $1.1 billion, or 43 percent.

Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1979
[In millions of dollars]

Date	Description	Allotted to private investors: For cash	Allotted to private investors: For refunding	Allotted to Federal Reserve and Government accounts	Total	Average auction yield (percent)
	NOTES AND BONDS					
1978						
Oct. 1 ..... 1½	percent note, Oct. 1, 1983[1]	.....	1	......	1	....
Oct. 2 ..... 8⅝	percent note, Sept. 30, 1980.........	711	2,684	511	3,906	8.65
Oct. 10.... 8⅝	percent bond, Nov. 15, 1993	1,509	.....	......	1,509	8.64
Oct. 31 .... 8⅞	percent note, Oct. 31, 1980..........	869	2,718	203	3,790	8.94
Nov. 15 ... 9¼	percent note, May 15, 1982	876	1,702	978	3,556	9.36
Nov. 15 ... 8¾	percent note, Nov. 15, 1988.........	819	1,695	931	3,445	8.85
Nov. 15 ... 8¾	percent bond, Nov. 15, 2003-08	564	1,187	678	2,429	8.86
Nov. 30 ... 9¼	percent note, Nov. 30, 1980.........	254	2,691	250	3,195	9.36
1979						
Jan. 2...... 9⅞	percent note, Dec. 31, 1980.........	363	2,733	450	3,546	9.99
Jan. 2...... 9⅜	percent note, Dec, 31, 1982	495	2,273	437	3,205	9.45
Jan. 11 9	percent bond, Feb. 15, 1994.........	1,502	.....	......	1,502	9.00
Jan. 31 .... 9¾	percent note, Jan. 31, 1981..........	291	2,704	151	3,146	9.85
Feb. 15.... 9	percent note, Feb. 15, 1987..........	710	1,568	931	3,209	9.01
Feb. 15.... 8¾	percent bond, Nov. 15, 2003-08	608	1,393	800	2,801	9.03
Feb. 28.... 9¾	percent note, Feb. 28, 1981..........	41	2,477	368	2,886	9.85
Mar. 5..... 9¼	percent note, Mar. 31, 1983	2,929	.....	......	2,929	9.35
Apr. 1..... 1½	percent note, Apr. 4, 1984...........	.....	(*)	......	(*)	(*)
Apr. 9..... 9⅝	percent note, Mar. 31, 1981	.....	2,879	640	3,516	9.68
Apr. 18.... 9	percent bond, Feb. 2, 1994..........	1,501	.....	......	1,501	9.14
Apr. 30.... 9¾	percent note, Apr. 30, 1981	1,021	1,833	159	3,013	9.78
May 15.... 9¼	percent note, May 15, 1989	1,368	910	350	2,628	9.37
May 15.... 9⅛	percent bond, May 15, 2004-09.....	1,198	809	200	2,207	9.23
May 31.... 9¾	percent note, May 31, 1981	455	1,848	239	2,542	9.77
July 2 ..... 9⅛	percent note, June 30, 1981	795	2,012	250	3,057	9.22
July 2 ..... 8⅞	percent note, June 30, 1983	1,252	1,625	246	3,123	8.89
July 9 ..... 8¾	percent bond, Aug. 15, 1994	1,506	.....	......	1,506	8.81
July 31 .... 9⅜	percent note, July 31, 1981..........	40	3,010	170	3,220	9.41
Aug. 15 ... 9	percent note, Aug. 15, 1982.........	981	1,831	775	3,587	9.06
Aug. 15 ... 9	percent note, Feb. 15, 1987..........	864	1,664	500	3,028	9.00
Aug. 15 ... 9⅛	percent bond, May 15, 2004-09.....	671	1,332	396	2,399	8.91
Aug. 31 ... 9⅝	percent note, Aug. 31, 1981.........	245	3,025	456	3,726	9.65
Sept. 5..... ¼	percent note, May 15, 1984	2,586	.....	......	2,586	9.25
	Total notes and bonds	27,024	48,601	11,069	86,694	....

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Offerings of marketable Treasury securities excluding refunding of regular bills, fiscal 1979—Continued
[In millions of dollars]

Date	Description	Allotted to private investors: For cash	Allotted to private investors: For refunding	Allotted to Federal Reserve and Government accounts	Total	Average auction yield (percent)
	BILLS (MATURITY VALUE)					
	Change in offerings of regular bills:					
1978	October-December	811	....	....	811	....
1979	January-March	3,709	....	....	3,709	....
	April-June	-4,261	....	....	-4,261	....
	July-September	1,494	....	....	1,494	....
	Total change in regular bills	1,753	....	....	1,753	....
	Other bill offerings:					
1979						
Mar. 2	9.698 percent 48-day, maturing Apr. 19, 1979	4,001	....	....	4,001	....
Apr. 13	9.861 percent 23-day, maturing Apr. 26, 1979	6,005	....	....	6,005	....
Apr. 13	9.912 percent 15-day, maturing Apr. 19, 1979	4,001	....	....	4,001	....
Apr. 6	9.616 percent 76-day, maturing June 21, 1979	3,001	....	....	3,001	....
June 4	10.056 percent 15-day, maturing June 19, 1979	5,010	....	....	5,010	....
June 5	10.080 percent 16-day, maturing June 21, 1979	4,517	....	....	4,517	....
Sept. 4	10.286 percent 14-day, maturing Sept. 18, 1979	2,004	....	....	2,004	....
	Total other bill offerings	28,539	....	....	28,539	....
	Total offerings	57,316	48,601	11,069	116,986	....

[1] Issued in exchange for 2¾ percent Treasury bonds, investment series B-1975-80.
* Less than $500,000.

The November 3 auction of 30-year bonds was well received, with $4,877 million of tenders submitted. Of the $1,752 million of tenders accepted, $163 million were noncompetitive tenders and $1,589 million were competitive tenders. The average yield was 8.86 percent and an 8¾-percent interest rate was assigned to the bond issue. Dealers received 0.8 billion, or 44 percent, and commercial banks received 0.6 billion, or 35 percent. In all, approximately $10.4 billion of new securities were sold, refunding a total of $8.2 billion of securities maturing November 15, 1978, and meeting the goal of raising $2.2 billion of new money.

On November 15 the Treasury announced an auction of $2.7 billion of 2-year notes, to refund the same amount of notes maturing November 30, 1978. The auction was held on November 21. Of the $4,963 million of tenders submitted, the Treasury accepted $2,692 million. Accepted tenders included $650 million of noncompetitive tenders and $1,867 million of competitive tenders. The average yield was 9.36 percent with a 9¼-percent interest rate

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Disposition of marketable Treasury securities excluding regular bills, fiscal 1979
[In millions of dollars]

Date of retirement	Securities: Description and maturing date	Securities: Issue date	Redeemed for cash or carried to matured debt	Exchanged for new issue at maturity	Total
1978	NOTES AND BONDS				
Oct. 1	1½ percent note, Oct. 1, 1978	Oct. 1, 1973	3	......	3
Oct. 31	5⅞ percent note, Oct. 31, 1978	Nov. 1, 1976	2,718	203	2,931
Nov. 15	6 percent note, Nov. 15, 1978	Nov. 15, 1971	5,620	2,587	8,207
Nov. 30	5¾ percent note, Nov. 30, 1978	Nov. 30, 1976	2,691	250	2,941
Dec. 31	8⅛ percent note, Dec. 31, 1978	Oct. 22, 1975	1,875	642	2,517
Dec. 31	5¼ percent note, Dec. 31, 1978	Dec. 31, 1976	3,131	245	3,376
1979					
Jan. 31	5⅞ percent note, Jan. 31, 1979	Feb. 3, 1977	2,704	151	2,855
Feb. 15	7 percent note, Feb. 15, 1979	Feb. 17, 1976	2,961	1,731	4,692
Feb. 28	5⅞ percent note, Feb. 28, 1977	Feb. 28, 1977	2,477	368	2,845
Mar. 31	6 percent note, Mar. 31, 1979	Mar. 31, 1977	2,879	640	3,519
Apr. 1	1½ percent note, Apr. 1, 1979	Apr. 1, 1974	2	......	2
Apr. 30	5⅞ percent note, Apr. 30, 1979	May 2, 1977	1,833	159	1,992
May 15	7⅞ percent note, May 15, 1979	Nov. 6, 1974	1,719	550	2,269
May 31	6⅛ percent note, May 31, 1979	May 31, 1977	1,848	239	2,087
June 30	7¾ percent note, June 30, 1979	July 9, 1975	1,582	200	1,782
June 30	6⅛ percent note, June 30, 1979	June 30, 1977	2,012	296	2,308
July 31	6¼ percent note, July 31, 1979	Aug. 1, 1977	3,010	170	3,180
Aug. 15	6¼ percent note, Aug. 15, 1979	Aug. 15, 1972	3,890	669	4,559
Aug. 15	6⅞ percent note, Aug. 15, 1979	Aug. 16, 1976	1,987	1,002	2,989
Aug. 31	6⅝ percent note, Aug. 31, 1979	Aug. 31, 1977	3,025	456	3,481
Sept. 30	8½ percent note, Sept. 30, 1979	Sept. 4, 1975	2,081	......	2,081
Sept. 30	6⅝ percent note, Sept. 30, 1979	Sept. 30, 1977	3,861	......	3,861
	Total coupon securities	......	53,909	10,558	64,467
1979	BILLS				
	Other:				
Apr. 19	9.698 percent (48-day)	Mar. 2, 1979	4,001	....	4,001
Apr. 19	9.912 percent (15-day)	Apr. 14, 1979	4,001	....	4,001
Apr. 26	9.861 percent (23-day)	Apr. 3, 1979	6,005	....	6,005
June 19	10.056 percent (15-day)	June 4, 1979	5,010	....	5,010
June 21	9.616 percent (76-day)	Apr. 16, 1979	3,001	....	3,001
June 21	10.080 percent (16-day)	June 5, 1979	4,517	....	4,517
Sept. 18	10.286 percent (14-day)	Sept. 4, 1979	2,004	....	2,004
	Total other bills	......	28,539	....	28,539
	Total securities	......	82,448	10,558	93,006

assigned to the notes. Commercial banks received $1.1 billion, or 37 percent, of the notes and dealers received $0.7 billion, or 22 percent.

The Treasury announced an auction of 2-year and 4-year notes totaling $5 billion on December 13, 1978. Intended to refund approximately the same amount of notes maturing December 31, the 2-year note auction on December 19 brought $5,315 million of tenders from the public, of which the Treasury accepted $2,510 million. Of the $2,510 million of tenders accepted, $655 million was tendered noncompetitively and $1,755 million competitively. Foreign add-ons of $535 million increased the issue size to $3,097 million. A 9.99-percent average auction yield led the Treasury to assign a 9⅞-percent coupon rate to the 2-year issue. Commercial banks were allotted $1 billion, or

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31 percent, of the notes while dealers accounted for $0.8 billion, or 27 percent.

The auction of 4-year notes on December 20 attracted $5,851 million of tenders, of which $2,507 million was accepted. The accepted $2,507 million included $740 million of noncompetitive tenders, and $1,667 million of competitive tenders. Foreign add-ons of $200 million increased the issue to $2.8 billion. Commercial banks received $1.2 billion, or 42 percent, of the notes and dealers received $0.8 billion, or 30 percent. The average auction yield was 9.45 percent, which resulted in a 9⅜-percent interest rate on the 4-year issue.

For the quarter ending December 31, total offerings of coupon securities amounted to $18.3 billion—$12.7 billion was for refunding maturing issues and $5.6 billion was for new cash. Compared with the comparable quarter in the 3 previous years, the October–December 1978 quarter was substantially less. Total new money from marketable coupons and bills amounted to $6.4 billion, compared with $19.4 billion in 1977, $14.2 billion in 1976, and $24.7 billion in 1975.

Over the course of the quarter, interest rates rose substantially with each of the Treasury coupon auctions bringing record yields in modern history for its maturity category. Yields on short coupons rose by 125 basis points or more while intermediate and long rates rose by more than 50 basis points. Yields on Treasury bills were the highest since the records set in the summer of 1974. Rates on 3- and 6-month bills rose about 125 basis points, and 52-week bills climbed 150 basis points.

January-March 1979.—On December 27, the Treasury announced an auction of $1.5 billion of 15-year 1-month bonds to raise new cash. The auction on January 4 brought $3,255 million of tenders. Of the $1,052 million of accepted tenders, $351 million were noncompetitive and $1,151 million were competitive. An average auction yield of 9.00 percent led to a 9-percent coupon rate. Commercial banks were allotted $0.5 billion, or 34 percent, of the issue, while dealers received $0.8 billion, or 51 percent.

Announced on January 17, 1979, and held on the 23d, the Treasury's auction of $2.7 billion of 2-year notes drew $4,044 million of tenders. The accepted $2.7 billion of tenders was to refund a similar amount of notes maturing January 31, 1979. The accepted tenders included $780 million of noncompetitive tenders and $1,756 million of competitive tenders. In addition, official foreign and international accounts were allotted $235 million of add-ons, raising the amount allotted to the public to $2.9 billion. Commercial banks received $1.1 billion, or 38 percent, of the issue, and dealers received $0.8 billion, or 26 percent. The 9.85-percent average auction yield led to a 9¾-percent coupon rate.

On January 31, 1979, the Treasury announced the February quarterly financing. Approximately $1.3 billion of new cash was to be raised and $3 billion of securities maturing February 15, 1979, was to be refunded by issuing $2.3 billion of 8-year notes and $2 billion of 29¾-year bonds.

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The 8-year note auction on February 6 attracted \$5,210 million of tenders, of which \$2,250 million was accepted. The accepted tenders included \$366 million of noncompetitive tenders, and \$1,884 million of competitive tenders from private investors. Commercial banks were allotted \$1 billion, or 44 percent, and dealers received \$0.8 billion, or 34 percent. The average auction yield was 9.01 percent, leading to an assigned coupon rate of 9 percent.

The 29¾-year bond auctioned February 7 drew \$4,304 million of tenders, of which \$2,001 million was accepted. The accepted tenders included \$62 million of noncompetitive tenders and \$1,939 million of competitive tenders from private investors. Commercial banks were allotted \$0.6 billion, or 28 percent, while dealers received \$1 billion, or 51 percent.

Through the sale of the two issues offered in the February financing, the Treasury raised approximately \$1.3 billion of new money and refunded \$4.7 billion of securities maturing February 15, 1979.

The Treasury announced an auction on February 13 of \$2.5 billion of 2-year notes to refund approximately the same amount of notes maturing February 28, 1979. The Treasury accepted \$2,248 million of the \$4,604 million of tenders received, including \$488 million of noncompetitive tenders and \$1,584 million of competitive tenders from private investors. Commercial banks received \$0.9 billion, or 37 percent, of the notes and dealers received \$0.6 billion, or 25 percent. An average auction yield of 9.85 percent led to a coupon rate of 9¾ percent.

On February 21 an auction of \$2.5 billion of 4-year 1-month notes to raise new cash was announced. Auctioned on February 27, the Treasury received \$6,734 million of tenders, and accepted \$2,502 million. Included in the accepted tenders were \$538 million of noncompetitive tenders and \$1,964 million of competitive tenders. Foreign add-ons of \$398 million increased the issue size to \$2.9 billion. The average auction yield was 9.35 percent and a coupon rate of 9¼ percent was set. Commercial banks were assigned \$1.4 billion, or 39 percent, and dealers received \$0.4 billion, or 15 percent.

The auction of \$2.9 billion of 2-year notes announced March 14, 1979, and scheduled for March 21 was postponed when Congress did not approve legislation in time to raise the temporary debt limit of \$798 billion. Without such legislation the temporary debt ceiling would expire on March 31, 1979, at which time the debt limit would revert to the permanent ceiling of \$400 billion, making delivery of the notes to be issued on April 2 impossible.

The postponement was announced on March 20, 1979. Subsequently, the Treasury had to postpone the sale of the following additional issues: \$6 billion of 23-day cash management bills, \$4 billion of 15-day cash management bills, \$6 billion of regular weekly Treasury bills, \$3.3 billion of annual bills maturing April 1980, \$3 billion of 76-day cash management bills, and \$1.5 billion of reopened 14-year 10-month Treasury bonds. Also, on March 30, the Treasury announced that the sale of U.S. savings bonds, retirement plan bonds, and individual retirement bonds would be suspended effective April 2, 1979, as a result of congressional failure to increase the debt limit.

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The 9¼ percent 4-year 1-month note issued on March 5 was the last coupon security issued in the January-March quarter. With this security, total offerings of coupon securities for the quarter amounted to $20.1 billion. About $13.2 billion was for refunding maturing issues and $6.9 billion was for new money. Total new money raised from both marketable coupons and bills for the quarter amounted to $10.6 billion. As in the first quarter of fiscal 1979, the amount of new money raised in the January-March 1979 quarter was considerably less than in the same quarter in the past 4 years; namely, $16.1 billion in 1978, $14.8 billion in 1977, $22.8 billion in 1976, and $17.5 billion in 1975.

For the January-March 1979 quarter as a whole, yields on Treasury marketable securities were mixed. During this period yields on 3-month Treasury bills rose 20 basis points, while 6-month bill yields held steady and 52-week bill yields declined about 30 basis points. In the coupon area short rates fell by 25 basis points and intermediate coupons dropped 5 to 15 basis points. Longer bond yields, however, gained 5 to 10 basis points.

April-June 1979.—On April 2, after the debt limit of $830 billion through September 30, 1979, was approved, the Treasury announced a revised schedule of offerings for the postponed securities. The sale of the 2.9 billion rescheduled March 2-year notes was held on April 5, and issued April 9. This auction to refund approximately $2.9 billion of notes maturing March 31, 1979, attracted $5,951 million of tenders. Included in the $2,881 million of accepted tenders were $730 million of noncompetitive tenders, $1,408 million of competitive tenders, and $9 million of foreign add-ons. The average was 9.68 percent, and a 9⅝-percent interest rate was set. Commercial banks received $0.9 billion, or 30 percent, of the notes and dealers received $0.6 billion, or 23 percent. About $0.8 billion of this issue was taken by foreign and international monetary authorities representing 26 percent of the issue.

In the rescheduled auction of the April 52-week bill which was held on April 4, the winning bidders submitted identical prices. This resulted in the high, low, and average yield being the same at 9.23 percent. Total tenders received amounted to $6,969 million, of which $3,344 million was accepted, including $197 million of noncompetitive tenders from the public and $1,599 million from Federal Reserve banks for themselves and as agents for foreign and international monetary authorities accepted at the average price.

On April 2, the Department of the Treasury announced the rescheduling of the auction of $1.5 billion of 9 percent 14-year 10-month bonds. This auction was to raise new cash and was an addition to the 9 percent bonds, due February 14, 1994. Auctioned on April 10, the Treasury accepted $1,500 million of the $2,649 million of tenders received from the public. Included in accepted tenders were $107 million of noncompetitive tenders and $1,393 million of competitive tenders. Commercial banks took $0.4 billion, or 28 percent, of the bonds and dealers took $0.8 billion, or 51 percent. The approximate average yield was 9.14 percent.

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The auction of $2.5 billion of 2-year notes to refund $1.8 billion of notes maturing April 30, 1979, and to raise $0.7 billion of new cash was announced on April 18 by the Treasury. Total tenders received amounted to $5,501 million, and $2,505 million was accepted including $393 million of noncompetitive tenders and $1,519 million of competitive tenders from private investors. In addition, there was $307 million of foreign add-ons. Commercial banks received $1.1 billion, or 39 percent, while dealers received $0.6 billion, or 22 percent. The average auction yield was 9.78 percent and a 9¾-percent interest rate was set on the issue. With the exchange of $593 million and add-ons of $307 million for a total of $910 million, this gave foreign investors almost 32 percent of the offering.

The Treasury's May quarterly financing was announced on April 25. About $2.5 billion of new cash was to be raised, and $1.9 billion of securities maturing May 15, 1979, was to be refunded by issuing $2.3 billion of 10-year notes and $2 billion of 30-year bonds.

At the May 1 auction of 10-year notes the Treasury accepted $2,255 million of the $6,233 million of tenders received from the public. Accepted tenders included $360 million of noncompetitive tenders and $1,895 million of competitive tenders. Commercial banks took $0.6 billion, or 26 percent, of the notes, and dealers took $0.8 billion, or 36 percent. The average auction yield for the 10-year notes was 9.37 percent, with an interest rate set at 9¼ percent.

The May auction of 30-year bonds attracted $4,837 million of tenders. The $2,005 million of accepted tenders included $162 million of noncompetitive tenders and $1,843 million of competitive tenders from private investors. Commercial banks received $0.7 billion, or 34 percent, and dealers received $1 billion, or 51 percent. The average auction yield was 9.23 and a 9⅛-percent interest rate was set.

On May 16, the announcement was made of a $2.2 billion offering of a 2-year note to refund $1.8 billion of notes maturing on May 31, 1979. Total tenders amounted to $4,764 million. There were $499 million of noncompetitive tenders and $1,284 million of competitive tenders received from private investors that were accepted. The interest rate on this security was set at 9¾ percent based on the average auction yield of 9.77 percent.

On June 13, the Treasury announced plans to auction $2.8 billion of 2-year notes and $2.8 billion of 4-year notes to refund $3.6 billion of privately held notes maturing June 30, and to raise new cash of $1.9 billion. The maturing notes included $823 million held by the Federal Reserve for foreign and international authorities.

For the 2-year notes, there were $5,761 million tenders submitted, of which $2,753 million was accepted. These included $654 million of noncompetitive and $1,404 million of competitive tenders. Also included were $695 million notes exchanged by foreign and international accounts. The notes were issued on July 2, with the rate set at 9⅛ percent based on the average auction yield of 9.22 percent.

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The auction of 4-year notes on June 21 resulted in accepted tenders of $2,754 million of the $4,218 million received including $543 million of noncompetitive tenders and $2,211 million of competitive tenders from private investors. Commercial banks took $1.3 billion, or 45 percent, of the issue and dealers were awarded $0.6 billion, or 21 percent. These notes were also issued on July 2.

The May 31, 2-year note was the last coupon security issued in the April–June quarter. The $2.3 billion received from this offering brought the total to $13.8 billion of coupons issued in the April–June quarter, of which $8.3 billion was for refunding maturing issues and $5.5 billion was for new cash. However, the new cash raised from the coupon issues was offset by a $5.6 billion paydown in bills. The resulting net cash paydown of $0.1 billion for the quarter was $0.2 billion less than the paydown in 1978 and $3.8 billion less than the paydown for the same quarter in 1977.

During the April–June quarter market interest rates on balance were lower. Treasury coupon yields reached their peaks in early May and thereafter posted dramatic declines for the balance of the quarter. Yields on coupon securities up to 3 years from maturity were down 40 to 70 basis points. Coupons in the 7- to 10-year area were 15 to 25 basis points lower, while long bond yields were 15 to 20 basis points lower. In the bill area, rates were down 35 to 45 basis points.

July–September 1979.—On July 9, the Treasury issued $1.5 billion 15-year 1-month bonds for cash. The offering was announced on June 20 and auctioned on June 27. Accepted in the auction was $1,501 million of the $2,784 million tenders received, including $88 million of noncompetitive tenders and $1,413 million of competitive tenders. The bonds were issued at a rate of 8¾ percent based on an average yield of 8.81 percent. Dealers were awarded $0.7 billion, or 47 percent, of the issue while commercial banks were allotted $0.5 billion, or 31 percent.

The Treasury announced on July 17 that it would auction $3 billion of 2-year notes on July 24, 1979, to refund that amount of maturing 2-year notes. The Treasury accepted $3,001 million of $4,669 million of tenders received from the public including $426 million of noncompetitive and $1,805 million of competitive tenders. Commercial banks received $0.8 billion and dealers took $0.5 billion of the issue, which amounted to 27 and 17 percent, respectively. These notes were issued July 31, 1979. The average yield was 9.41 percent, resulting in an interest rate of 9⅜ percent.

The August quarterly financing announced on July 25, 1979, indicated plans to refund $4.8 billion of maturing securities and to raise $2.4 billion in cash. Three issues were offered: a 3-year note, a 7½-year note, and a 29¾-year bond.

There were $6,725 million tenders received for the 3-year note, of which $2,753 million was accepted. These included $611 million of noncompetitive tenders and $1,562 million of competitive tenders from private investors. Commercial banks and foreign investors were heavy subscribers with $1.4

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billion, or 50 percent, and $0.6 billion, or 21 percent. The rate on this security was determined to be 9 percent based on an average yield of 9.06 percent.

The 7½-year notes auctioned August 1, 1979, also produced a 9-percent rate based on the average auction yield of 9.00 percent. There were $2,504 million tenders accepted from the $5,367 million received, including $411 million noncompetitive and $1,793 million competitive from private investors. Commercial banks acquired $0.9 billion, or 37 percent, of the issue, while dealers were allotted $0.7 billion, or 27 percent.

The third issue in the August refunding was a 29¾-year bond. The rate was set at 9⅛ percent based on the average approximate yield to maturity which was 8.92 percent. Accepted from the public were $2,000 million in tenders from the $3,137 received. Competitive bids were $1,850 million of the total and noncompetitives were $150 million. Dealers took the largest amount of these securities, $1.2 billion, or more than 60 percent.

On August 14, 1979, the Treasury announced the sale of $3.3 billion of 2-year notes to refund the notes maturing August 31, 1979. The interest rate set by the auction was 9⅝ percent based on an average yield of 9.65 percent. There were $3,255 million in tenders accepted of the $6,995 million received. The accepted tenders included $585 million in noncompetitive tenders and $1,710 million competitive tenders from private investors. Commercial banks and foreign and international monetary authorities were the largest subscribers, taking $1.1 billion and $960 million, or nearly two-thirds of the offerings.

A week later on August 21, 1979, the Treasury announced that it would auction $2.5 billion of 4-year 8-month notes to raise new cash. Of the $5,308 million of tenders received, $2,502 million was accepted including $378 million of noncompetitive bids and $2,124 million of competitive bids. In addition, $60 million was accepted from foreign and international accounts, bringing the total from private investors to $2,562 million. Commercial banks were allotted $1.1 billion, or nearly 42 percent, of the issue. These securities were issued September 5, 1979, with a 9¼-percent interest rate based on an average auction yield of 9.25 percent.

The announcement to refund the $5.3 billion of maturing September 30, 2-year and 4-year notes and raise $0.5 billion in new cash was made on September 18, 1979. The notes were to be auctioned on September 25 and 26 provided Congress had approved legislation to raise the temporary debt ceiling before it expired on September 30, 1979. However, these refundings had to be postponed to October 3 and 4 because Congress had failed to act on the debt limit in time.

The 9¼ percent 4-year 8-month note issued on September 5 was the last coupon security issued in fiscal 1979. The $2.6 billion of new cash raised from this security brought total coupon offerings in the fourth quarter of fiscal 1979 to $23.4 billion, of which $14.5 was for refunding maturing issues and $8.9 billion was for new cash. With $1.4 billion raised from Treasury bills, net new cash for the quarter amounted to $10.4 billion. For the fiscal year as a whole, net new cash amounted to $27.3 billion.

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During the final quarter of fiscal 1979, interest rates were rising steadily throughout the maturity spectrum and Treasury yields easily surpassed previous records. By the end of the fiscal year, rates on 13-week, 26-week, and 52-week Treasury bills had all increased by more than 130 basis points over the quarter. Yields on coupon securities due within a year increased by nearly 150 basis points, while yields on intermediate-term securities increased over 100 basis points for 3-year maturities, 70 basis points for 7-year maturities, and nearly 65 basis points for 10-year maturities. In the bond area, rates had increased by more than 50 basis points by yearend.

Federal Financing Bank

The Federal Financing Bank (FFB) is a corporate instrumentality of the United States which is subject to the general supervision and direction of the Secretary of the Treasury. It is managed and operated by Treasury employees who provide services to the FFB on a reimburseable basis. The FFB was established by the Federal Financing Bank Act of 1973 to coordinate, reduce the costs of, and efficiently finance Federal agency and federally guaranteed obligations. The FFB is authorized to purchase any obligation which is issued, sold, or guaranteed, in whole or in part, by a "Federal agency"—defined in the act as any executive department, Federal establishment, corporate or other entity established by Congress and at least partially owned by the U.S. Government.

The act authorizes the FFB to issue its own debt obligations to the Secretary of the Treasury and up to $15 billion in debt to the public. Current FFB policy is to issue obligations solely to the Treasury and to purchase only direct agency or fully guaranteed obligations. The current FFB lending rate is 1/8 of 1 percentage point above its borrowing rate, which is based on the market yield on Treasury obligations of comparable maturity.

Since it began operations in 1974, the FFB has become the vehicle for most eligible Federal and federally assisted borrowings. Current exceptions are the Government National Mortgage Association guaranteed mortgage pass-through securities, the Department of Housing and Urban Development (HUD)-guaranteed tax-exempt public housing and urban renewal notes and bonds, and the Department of Commerce-guaranteed title XI ship mortgage bonds. These programs are now being financed in the private credit markets; the FFB will begin to acquire the HUD project bonds during fiscal 1980. The securities of the farm credit banks, the Federal home loan banks, and the Federal National Mortgage Association are not eligible for purchase by the FFB since these agencies are federally sponsored, not federally owned, and their obligations are not guaranteed by any Federal agency.

As of September 30, 1979, FFB holdings totaled $64.2 billion, an increase of $16.1 billion during the fiscal year. The Farmers Home Administration sales of loan assets to FFB accounted for 55 percent of this increase. FFB purchases of agency debt (Tennessee Valley Authority, U.S. Postal Service, Export-Import Bank) were responsible for 18 percent of the increase in

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holdings during the year. Lending under various Federal guarantee programs totaled $3.9 billion, including $1.3 billion to foreign governments under Department of Defense guarantees and $1.7 billion to rural electric and telephone cooperatives, guaranteed by the Rural Electrification Administration.

During fiscal 1979, the FFB began lending to local governments under the HUD Community Development program. HUD guarantees obligations issued to FFB by local governments to finance purchases and rehabilitation of real property, under section 108 of the Community Development Act of 1974. The Community Development projects are ultimately funded by HUD grants, and the guarantee is secured by these grants. On September 30, 1979, FFB holdings under this program totaled $5.4 million.

FFB net income during fiscal 1979 totaled $115 million, with administrative expenses of $443,000 and no operating losses. A resolution to transfer FFB's accumulated surplus, less an operating reserve, to the Treasury general fund had been submitted to the FFB Board of Directors but had not been acted on at the close of the fiscal year.

Capital Markets Policy

The Office of the Deputy Assistant Secretary for Capital Markets Policy includes the Office of Capital Markets Legislation (responsible for the development of administration policy on legislation affecting banks and other financial institutions), the Office of Securities Markets Policy (primarily concerned with the corporate securities markets and with equity capital formation), and the Office of Corporate Finance and Special Projects (primarily concerned with special problems related to domestic finance).

In the area of capital markets legislation, the Office was instrumental in developing the President's financial reform program, introduced by a Presidential message on May 22 following a 2-year interagency task force study led by Treasury.[1] At this writing, legislation is currently pending in Congress to implement the program. The report of the task force is available to the public. The program and legislation would phase out deposit interest rate controls, authorize nationwide negotiable order of withdrawal (NOW) accounts at all depository institutions, and authorize federally chartered thrift institutions to invest up to 10 percent of their total assets in consumer loans. The Office was responsible also for the McFadden Act study requested by the Congress in the International Banking Act of 1978. It examines the impact of the McFadden Act, as amended, which restricts branching by commercial banks. Also, the Office has continued its role advising the Secretary as a Director of the Pension Benefit Guaranty Corporation and the Assistant Secretary as a Director of the National Consumer Cooperative Bank. Further, the Office of Securities Markets Policy monitors structural and regulatory changes in the securities industry, including development of the

[1] See exhibit 13.

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National Market System and problems of security firms associated with the cyclical conduct of monetary policy.

In addition, the Office was responsible for analyses underlying the administration's views on proposed legislation to stem attrition in Federal Reserve membership, the Government's role in the provision of electronic funds transfer services, legislation dealing with permissible activities of bank holding companies, and the impact of tight monetary policy on the viability of financial institutions and on the flow of funds to housing credit.

In the securities markets area, the Office has continued its review of proposed changes in the restrictions governing the securities activities of commercial banks, including proposed legislation to permit further bank entry into underwriting/dealing in municipal revenue bonds.

The Office of Capital Markets Policy was expanded this year with the creation of an Office of Corporate Finance and Special Projects. This office has primary responsibility for dealing with programs of financing assistance to private firms, and has had staff responsibility for policy and financial issues related to the President's proposal for $1.5 billion in Federal financing assistance to Chrysler Corp. It also represents the Treasury in performing the Secretary's statutory role as a Director of the U.S. Railway Association, the Department's role on the Capital Formation and Innovation Task Force of the Steel Tripartite Commission, and provides representation and staffing on other special projects in the finance area on both ongoing and ad hoc bases.

State and Local Finance

The Deputy Assistant Secretary for State and Local Finance is responsible for the Offices of New York Finance, Urban and Regional Economics, State and Local Fiscal Research and Evaluation, and Municipal Finance. The overall mission of these offices includes: Policy development for general-purpose fiscal assistance programs such as general revenue sharing; assessing the impacts of Federal aid on patterns of fiscal federalism; monitoring State and local fiscal trends and local access to securities markets, including specifically the situation in New York City in connection with the Department's responsibilities under the provisions of the New York City Loan Guarantee Act of 1978; advising the Secretary of the Treasury concerning Federal responses to State and local fiscal problems and the role of general fiscal assistance in economic stabilization policy; and representing the Department of the Treasury before public interest groups and Congress on intergovernmental fiscal matters.

The Deputy Assistant Secretary has policy responsibility for the Office of Revenue Sharing, a separate agency within Treasury, on matters involving general revenue sharing. This responsibility will be especially important in 1980, as the administration's position on the program is transmitted to Congress and the renewal process proceeds.

The Deputy Assistant Secretary also serves as the Department's principal or deputy liaison with several interagency groups responsible for coordina-

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tion of administration policies and programs directed to the State and local sector such as rural and urban development and the Interagency Coordinating Council. The latter was established as a key element of the President's urban program announced in March 1978. The offices also deal with State and local governments directly and through their interest groups in Washington.

Office of New York Finance

During fiscal 1979, the Office of New York Finance exercised the Department's oversight responsibility for the loan program to New York City pursuant to the provisions of the New York City Loan Guarantee Act of 1978 (Public Law 95–339). This act authorizes the Secretary to extend up to $1.65 billion in Federal guarantees of city debt through June 30, 1982, when the act expires.

During this period, the city is required to achieve a balanced budget in accordance with generally accepted accounting principles and to implement other budget and financial reforms. These actions should enable the city to regain access to conventional borrowing sources so that, by June 30, 1982, it will be able to meet its short- and long-term financing needs in the public credit markets.

Under the terms of Public Law 95–339, the Secretary of the Treasury may extend guarantees only if, among other things, there is a reasonable prospect of repayment of the city indebtedness, the city is unable to obtain credit in the public markets or elsewhere, and the city is making substantial progress toward a balanced budget in accordance with generally accepted accounting principles by its fiscal 1982.

In fiscal 1979, the Secretary determined the city has been in compliance with the conditions set forth in the act, and $500 million in guarantees were extended.

Office of Municipal Finance

The Office of Municipal Finance continues in its duties to review developments and proposals in the fiscal management and financial administration of State and local governments. It gives particular attention to State-local government budgetary and accounting practices. In addition, the Office reviews the impacts of tax and/or expenditure controls on State and local government finance.

The Office gives significant attention to current issues that may affect the municipal credit market. These include issues relating to governmental accounting principles, the development of uniform financial disclosure in the sale of State and local securities, and the impact on credit markets of new Federal bankruptcy laws for municipalities.

The Chrysler Corp.'s request for Federal loan guarantee assistance prompted the completion of several special studies by the Office on the impact of Chrysler on State and local finances.

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Office of State and Local Fiscal Research and Evaluation

In 1979, the Office of State and Local Fiscal Research and Evaluation played an important role in the development of the administration's proposals for a targeted fiscal assistance (TFA) program to replace the now-expired antirecession fiscal assistance program. The administration proposal has two tiers: A targeted tier featuring a formula that would target funds to fiscally stressed local governments, and a standby countercyclical fiscal assistance tier that would trigger in case of a serious national recession. A similar bill was approved by the Senate and hearings have been held on that bill in the House.

The Chrysler Corp.'s request for Federal loan guarantee assistance created a requirement for evaluation by this Office. The Office performed an analysis of the potential of Federal assistance using existing programs to help areas impacted by Chrysler.

The capacity of the Office to carry on research and evaluation was strengthened in 1979 by increasing its direct access to computer models and data bases. This additional capacity is also used by the Office of Urban and Regional Economics.

The Office assisted the Office of New York City Finance in evaluation of the sensitivity of New York City's present and projected fiscal position to a national economic downturn deeper than anticipated in most economic forecasts.

Office of Urban and Regional Economics

The Office of Urban and Regional Economics was established to evaluate local and regional economic trends and their impact on the fiscal condition of State and local governments. In addition, it assesses the impacts of specific Federal economic policies on local economies.

In early 1979, the Office continued to participate in executive branch consideration of alternative programs to assist economic development in urban areas. In midyear, the lead for these programs was transferred to the Economic Development Administration of the Department of Commerce, and the Office turned its attentions to other matters.

In preparation for congressional consideration of the renewal of general revenue sharing, the Office is responsible for monitoring a major contracted study of the fiscal impacts on nine States of changes in or elimination of the States' share of general revenue sharing. The Office serves as liaison with other organizations such as the General Accounting Office that are considering this issue.

Primary analytic work in preparing Treasury's proposals for the renewal of general revenue sharing is being carried out in this Office. While a number of activities are essential to this effort, the most critical has been the analysis and evaluation of the effects of modifications in the program's fund-allocation formula.

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ECONOMIC POLICY

The Office of the Assistant Secretary for Economic Policy (OASEP) is responsible for informing the Secretary and other senior policy officials of the Department on current economic developments, advising them concerning prospective economic developments, and assisting them in the development of appropriate domestic economic policies. The office also has responsibility for macroeconomic analyses pertinent to the formulation of international economic policies which affect U.S. economic growth, inflation, foreign trade, and capital flows. The office participates in an interagency group that produces official projections of the U.S. economy which serve as the basis for budgetary planning and for choosing among alternative courses of economic policy. The Office of Economic Policy also prepares testimony, briefing, and general background material for the Secretary and Deputy Secretary to use in appearances before congressional committees concerned with economic policies. Staff support for these activities is provided by the Office of Financial Analysis, the Office of Special Studies, and the international offices of Balance of Payments, Monetary Research, Trade Research, International Energy Research, Statistical Reports, Foreign Portfolio Investment Survey, and Data Services.

A series of biweekly briefings for the Secretary and other senior policy officials initiated in 1977 continued through 1979. These briefings are coordinated by the Office of Financial Analysis and conducted in cooperation with other domestic and international offices within Treasury. The briefings consist of analyses of important economic and financial developments of both domestic and international scope and supplement the flow of information provided through other channels.

In addition, OASEP works with the Council of Economic Advisers, the Office of Management and Budget, the Domestic Policy Staff, and various other agencies in analyzing and formulating a number of specific policy initiatives for discussion by the Economic Policy Group. The work included several projects in the area of energy (including a section 232 investigation of the security aspects of oil imports), a review of tax incentives for investment, a survey of countercyclical policies, an analysis of Federal credit programs, analyses of financial institutions and markets, development of a draft bill on health insurance, and a review of the annual report of the social security system trustees. OASEP also had a major role in assessing the economic and regional implications of a Chrysler Corp. shutdown.

Office of Financial Analysis

The Assistant Secretary for Economic Policy represents Treasury on an interagency group which develops the official economic forecasts used for the administration's budgetary and economic policy decisions. Other agencies participating in this group are the Council of Economic Advisers, Office of Management and Budget, and the Departments of Commerce and Labor.

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Staff of the Office of Financial Analysis provided support for the Assistant Secretary in this role and regularly attended meetings of the forecasting group.

Compilation and evaluation of current economic data and information is an essential element in the formulation of economic policy. To support the Department's economic policy function, the Office routinely prepares an Economic Briefing Book for the Secretary of the Treasury and other high-level Treasury officials. The briefing material provides comprehensive coverage of all of the major economic statistics and includes historical perspectives. Memoranda prepared for the briefing book circulate throughout the Treasury and provide a major vehicle for keeping Treasury officials informed of current economic developments.

Supplementing the briefing book, the Office prepares a weekly summary of economic developments which gives an overview of current economic performance and evaluates prospects for the future course of the economy. The Office also has primary responsibility for a biweekly economic and financial briefing for senior Treasury officials.

As a principal contributor to the formulation of economic policy, Treasury is requested by congressional committees to explain and elaborate upon the economic goals and objectives of the administration. In support of this function the Office prepares briefing and general background material for the Secretary and Assistant Secretary for Economic Policy to use in testifying before the Joint Economic Committee, congressional budget committees, and other committees concerned with economic and financial policies.

Officials of the Department serve as attaches in the embassies and missions to several foreign nations. In order to keep these officials, as well as other Treasury personnel, well informed about current economic developments, the Office prepares a comprehensive review of domestic and international economic and financial developments.

Public awareness of economic developments and acceptance of government policies are important to achieving stated goals and objectives. The Office of Financial Analysis conducts occasional briefings for private groups and organizations on the current economic performance and economic outlook. In addition, the Office has contributed to a broader understanding of economic policies by mid- and upper-level career civil servants throughout Government by making presentations at executive training programs conducted by the Office of Personnel Management.

The Office provided extensive support in the Department's evaluation of Chrysler Corp.'s request for financial assistance. A comprehensive study of the economic impacts of alternative scenarios of Chrysler's future development became part of the testimony submitted by the Secretary to the Congress.

The Office also assisted the Bureau of the Mint in its long-range planning for the currency system by providing a detailed assessment of inflationary implications of various currency decisions.

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Office of Special Studies

The Office of Special Studies provided a number of analyses and evaluations of economic issues for use by the Secretary, the Assistant Secretary for Economic Policy, and the Economic Policy Group. It also prepares testimony, briefing, and other material for use in appearances before congressional committees. Some of the major areas of concern follow:

Section 232 investigation.—The volume and source of oil imports during the past year continued to be a matter of national concern from a security viewpoint. At the direction of the Secretary of the Treasury, an investigation was conducted under the provisions of section 232(b) of the Trade Expansion Act to determine if oil was being imported in such quantities and under such circumstances as to threaten to impair the national security. The investigation was completed in March 1979 and submitted to the President. The investigation concluded that the current volumes of oil imports do constitute a threat to the national security. This finding provided the President with a legal basis by which he could take action to limit the volume of petroleum imports.

Oil import quotas.—In order to reduce the volume of oil imports, the President directed the Secretaries of Energy and the Treasury to jointly develop a method for limiting oil imports. Treasury staff worked with the Department of Energy to develop a system to hold oil imports to the goal established by the President. Public hearings to consider various alternatives were still in progress at the end of fiscal 1979. Development of the final mechanism is continuing.

Synthetic fuels program.—As part of the national energy program, the development of synthetic fuels has been encouraged. Of particular potential is the development of crude oil substitutes from our vast resources of shale and coal. Office of Special Studies personnel and other Treasury staff participated with the Department of Energy in the preparation of an administration program for the commercial development of synthetic fuels.

Solar energy.—Increasing emphasis has been given to energy production from renewable sources such as the sun. At the direction of the President, Treasury staff participated in a major study effort chaired by the Department of Energy to determine the energy potential available from solar sources and how this potential might be achieved. Treasury's primary contribution in the study included a review of the most appropriate methods for the Federal Government to provide the economic incentives to realize the solar potential.

Tax incentives for investment.—The rate of productivity growth has slowed considerably during the past few years. There is considerable support for the view that the rate of capital formation played a significant role in the decline. In view of the importance of increased productivity growth in the long-term solution to the Nation's inflation problem, the Office of Special Studies undertook a detailed review of the existing theoretical and empirical literature on the relative effectiveness of a number of investment tax

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incentives. This review was augmented by econometric simulations of the impacts of various tax incentives.

Countercyclical policies.—The Tax Reduction and Simplification Act of 1977 utilized an array of countercyclical measures to stimulate the economy including local public works projects, public service employment, antirecession fiscal assistance, and employment tax credits. Sufficient time has since elapsed to evaluate the effectiveness of each of these programs for countercyclical purposes, and a survey of the research available was conducted.

Federal credit programs.—In the fiscal 1980 budget, the President proposed to establish a system of control over Federal credit programs. The Office of Special Studies is participating in the interdepartmental task force providing the various economic and budget analyses required to formulate a Presidential proposal. Some of the issues being analyzed are the measurement and effect of the subsidies provided by these programs.

Teamsters strike.—In early 1979, there was considerable concern in the administration that a prolonged Teamsters Union strike would impose a serious economic hardship and burden on the U.S. economy. Much uncertainty existed as there had never been a nationwide trucking strike. Treasury participated in an interagency task force established to monitor and analyze the economic impact of a strike and to evaluate the potential threat to the Nation's health and security. The strike was eventually settled after 10 days; no serious damage was inflicted upon the economy. The Office of Special Studies prepared analyses of the impacts of the 10-day work stoppage and the final negotiated settlement upon the economy.

Financial institutions and markets.—The Treasury's contribution to administration positions on issues of financial policy was supported by studies conducted by the staff of the Office of Special Studies. Areas of inquiry included residential mortgage finance, monetary policy and credit market developments, corporate finance and liquidity, and developments in private money market instruments.

Analyses of legislative and regulatory proposals affecting the financial markets were also conducted by the Office of Special Studies. Such proposals included the phaseout of interest rate ceilings on deposits, changes in reserve requirements on member bank liabilities, commercial bank participation in the municipal revenue bond market, amendments to the Credit Control Act, and anti-inflation standards for financial institutions issued by the Council on Wage and Price Stability.

Health insurance.—The President sent to Congress his national health insurance (NHI) draft bill on September 25, 1978, following several months of intensive staff work within the administration. The Secretary of the Treasury is a key adviser to the President on NHI as this issue has important implications for the Nation's economic and budget policies. The Office of Special Studies participated in interdepartmental work groups on various

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aspects of NHI and provided economic analyses for various NHI program options.

Social security.—The Social Security Amendments of 1977 call for several tax rate increases before 1990, which have important economic implications including their impact on inflation and the tax burden of employers and employees. Treasury undertook analyses of proposals for changes in trust fund financing and benefit structures and their impact on the economy. The impact of current economic forecasts on the financial status of the trust fund was also assessed. In addition, Treasury staff participated in the review of the economic assumptions and estimates underlying the trustees annual report on the social security system.

National Productivity Council.—As a member of the National Productivity Council, Treasury participated in activities and studies directed toward productivity improvement in the Government and private sectors.

Government regulation.—Executive Order 12044, issued in March 1978, was a major Presidential initiative to assure that the legitimate goals of Federal regulation are achieved at the least possible cost. As part of the implementation of the Executive order, the Regulatory Analysis Review Group (RARG), a high-level interagency committee that includes Treasury and other economic and regulatory agencies, was created. During fiscal 1979, the RARG reviewed analyses of several major proposed rules including the Environmental Protection Agency's (EPA) proposed rules on the transportation, storage, and disposal of hazardous wastes; EPA performance standards for steam electric plants; and Department of Energy coal conversion regulations under the Fuel Use Act.

Office of Trade Research

The Office of Trade Research is responsible for performing substantive economic analyses of issues confronting the Department of the Treasury related to international trade and U.S. commercial policies. Thus, the Office of Trade Research might be requested to analyze the effects on U.S. trade, or on the U.S. economy as a whole, of various developments in international markets for traded goods such as U.S. or foreign measures to protect domestic industries and their workers from foreign competition, changes of exchange rates among world currencies, and new international agreements to reduce tariffs and other barriers to trade or to establish multilateral buffer stocks for commodity price stabilization.

During fiscal 1979, the Office of Trade Research undertook and completed a number of research projects and activities. Among the major projects completed are the following:

Analyses of alternative methods of calculating effective changes in the dollar exchange rate.—This study compared the effects of several "practical" methods for computing the change of the dollar exchange rate vis-a-vis other currencies with an "ideal" measure which is conceptually correct but requires unavailable data. The results indicate that among the practical alternatives

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bilateral trade-weighted averages of exchange rate changes are more appropriate than multilateral trade-weighted averages, and that when exchange rate changes are relatively large in magnitude, averages of bilateral exchange rate changes should be calculated as geometric rather than arithmetic averages. These results contributed to an internal reevaluation of the Department's published series on the average foreign exchange value of the U.S. dollar.

The cost of import protection to the U.S. economy.—This project was part of Treasury's program in support of legislation to approve and implement the multilateral trade agreements. The study found that in 1978 the cost to U.S. consumers of import barriers was approximately $80 billion, while the net cost to the United States was $4.2 billion in the short run and $8.16 billion in the long run.

In a related exercise, the Office participated in an interagency task force to develop methods for measuring the costs and benefits to the economy as a whole of "escape-clause" relief for industries injured by import penetration.

The compensatory financing facility and export instability.—To support the Department's evaluation of proposed changes in the IMF's compensatory financing facility, the Office estimated the impact of the facility on the stability of user countries' (particularly LDC's) export receipts. Results indicated that the impact has been minimal and further analysis showed that operating the facility in such a way as to stabilize export receipts of user countries would require more accurate forecasts of these countries' export receipts (2 to 3 years into the future) than are currently available.

The impact of changes in the dollar exchange rate on direct foreign investment in the United States.—Analysis of exchange rate and direct foreign investment data from the period 1963 to 1977 indicates that changes in the relative value of the dollar served to accelerate or delay incoming foreign direct investment in the United States. This finding is consistent with the belief that the recent decline of the dollar has encouraged a higher level of investment in the United States. Further analysis, however, demonstrated that the recent pattern of direct foreign investment and exchange rate movements are not consistent with the earlier pattern.

Performance of Eximbank programs to foster U.S. exports in fiscal 1978.—This study examined the detailed records of Eximbank commitments to support U.S. exports in fiscal 1978 to determine the probable extent to which Eximbank commitments supplemented rather than supplanted financing available for U.S. sales abroad in private capital markets. For Eximbank direct loan commitments it also examined the apparent strength of foreign official credit competition to determine whether U.S. export sales might have been lost without Eximbank support because of trade-distorting practices of foreign official credit agencies. The results indicate that in fiscal 1978 Eximbank was highly successful in fostering exports through its direct loan program. However, they also indicate that the Bank was largely unsuccessful in fostering exports through its guarantee and insurance programs, because

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the characteristics of Eximbank's guarantee and insurance commitments were found to be indistinguishable from those existing in private credit markets.

The Office also completed a number of other projects directly related to trade policy issues. Among them was the development of a data base which identifies U.S. import flows by the major trade policies (tariffs, quotas, offshore assembly provisions, etc.) which affect them.

A number of projects were done in direct cooperation with policy officials and did not result in a formal Office of Trade Research paper. Efforts of this sort included analysis of evidence related to several antidumping cases, an analysis of proposals to reform the OECD Consensus on official financing of exports, and an analysis of the conceptual and technical difficulties in estimating the domestic inflationary effects of exchange rate changes.

Office of International Monetary Research

The primary functions of the Office of International Monetary Research include the following: Analysis of the trade and monetary consequences of changes in U.S. and foreign government policies; evaluation (in coordination with operational offices in OASIA) of proposals to amend or reform the international monetary regime; providing quantitative assessments of effects of unexpected developments abroad; making specific forecasts of various foreign economic variables; monitoring current economic research in the international macroeconomic and monetary areas; and advising senior Treasury officials on the likely policy relevance of the results and findings of this research.

Major projects undertaken by the Office of International Monetary Research in fiscal 1979 included, among others, development of operational capabilities to use commercially available large-scale multicountry econometric models for the purpose of conducting policy simulations; construction of a framework (model plus computational algorithm) suitable for investigation of alternative corporate investment strategies using diversified portfolios; completion of a survey study dealing with macroeconomic policies under a flexible exchange rate regime; further work on developing medium-size econometric models of U.S. main trading partnership; and undertaking a large-scale empirical study on the impact of import competition on pricing behavior of U.S. manufacturers.

Office of International Energy Research

The Office of International Energy Research focuses on how international flows of energy resources and technologies affect Treasury responsibilities for economic policy, the balance of payments, and monetary affairs.

International Energy Research was a major contributor to the Secretary's report to the President on the "National Security Implications of Oil Imports." The investigation, under the authority of section 232b of the Trade Expansion Act, gives the President the authority to take action to limit oil

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imports. The Office later worked with the interagency task force examining alternatives to reduce U.S. dependence on foreign petroleum.

The Office also examined, in several briefing papers and reports for the Secretary, the implications of the Iranian crisis for the world petroleum situation. Related work has been undertaken with the Internal Revenue Service concerning the valuation of crude oil and its balance of payments implications.

International Energy Research provides Treasury officials with expertise regarding the economics of nuclear energy and its impact on international trade. In this context, the Office represents the Treasury in the Interagency Group on World Nuclear Power Developments and Proliferation. Two reports on nuclear fuel policies and financial arrangements in leading industrial countries were prepared in this Office as a result of nuclear conferences in London and Copenhagen, respectively.

Additional topics addressed for the Secretary and other Treasury policymakers included Chinese energy policy and its implications for U.S. exports, OPEC investment and the dollar, the effect of changing oil prices on developing countries, and the supply response in non-OPEC countries to oil price increases. The Office also examined real prices of oil imports to industrial countries as well as the effect of dollar denomination of crude oil prices on the exports of countries whose currencies appreciated with respect to the U.S. currency. The Internal Revenue Service commended this Office for its assistance in a major case on the valuation of technology in international transfers.

The President's Speakers Bureau has frequently called on this Office to address business and consumer groups interested in understanding the economic implications of energy issues. Following the initiatives announced in the President's July 15 speech, emphasis has been placed on articulating the importance of the President's energy policy to the American people.

Office of Balance of Payments

The Office of Balance of Payments has staff responsibility for briefing and advising the Secretary and other policy officials on the current situation and outlook for our international payments, including the merchandise trade balance, other current account transactions, and official and private international capital flows. The Office also represents the Treasury in technical meetings of various interagency groups and international organizations such as the International Monetary Fund and the Organization for Economic Cooperation and Development.

The merchandise trade deficit for the fiscal year was $27 billion, an improvement of $10 billion from the fiscal 1978 deficit of $37 billion.

This gain was mostly attributable to improved U.S. price competitiveness resulting from depreciation of the dollar (which, during the previous fiscal year, declined about 12 percent against the currencies of other OECD countries). It reflected both faster growth of nonagricultural exports (which

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U.S. current account transactions, October 1978–September 1979
[Seasonally adjusted; $ billion]

	Fiscal 1978 (quarterly averages)	Fiscal 1979*			
		Oct.–Dec. 1978	Jan.–Mar. 1979	Apr.–June 1979	July–Sept. 1979
Exports	33.0	39.4	41.3	42.8	47.3
Agriculture	7.0	7.8	7.6	7.7	9.6
Other	26.1	31.6	33.7	35.1	37.7
Imports	-42.3	-45.4	-47.5	-50.5	-54.6
Petroleum and products	-10.5	-10.8	-11.6	-12.9	-16.6
Other (including other fuels)	-31.8	-34.5	-35.8	-37.6	-38.0
Trade balance	-9.2	-6.0	-6.1	-7.7	-7.3
Net services and remittances	5.2	6.8	7.3	7.6	8.9
Government economic grants	-.7	-.8	-.8	-.9	-.9
Net invisibles	4.5	6.1	6.5	6.7	8.0
Balance on current account	-4.7	.1	.4	-1.1	.8

* Due to seasonal adjustment on calendar-year basis, quarterly data will not add precisely to fiscal year totals.
Source: Survey of Current Business, June and December 1979, published by U.S. Department of Commerce, Bureau of Economic Analysis.

increased 32 percent in value, compared with 8 percent the previous year) and a slowing of nonpetroleum imports (to a 15-percent growth rate from 24 percent previously).

Also, agricultural exports, reflecting good supplies and strong foreign demand for wheat, corn, and soybeans, increased $4.7 billion from the previous fiscal year, to about $33 billion.

Offsetting about half of these gains, however, was a $10 billion increase in the cost of petroleum imports, from $42 billion in fiscal 1978 to $52 billion. This reflected a 58-percent rise in average import prices over the course of the fiscal year (from July–September quarter of 1978 to July–September 1979) although there was a 3.5-percent decline in volume.

The current account deficit for the fiscal year was $400 million, representing an $18.5 billion improvement from the fiscal 1978 deficit of $18.9 billion. This reflected a $9 billion increase, to $27 billion, in the surplus on net invisibles (services and transfer payments) in addition to the gains on trade account. Notable among the services transactions was a $12 billion increase in income on U.S. direct investment abroad.

For the year as a whole, net recorded outflows of private capital rose from $18 billion in fiscal 1978 to $23 billion, while U.S. Government lending was substantially unchanged at $3.8 billion. Financing of these outflows (plus the small current account deficit) included a positive statistical discrepancy of $17 billion, a $4.9 billion inflow of foreign official assets, and a $5 billion rundown of U.S. reserve assets (including proceeds from Treasury foreign currency notes issued abroad and an IMF allocation of SDR's).

During the first quarter (October–December 1978), when the dollar was under strong pressure on exchange markets, private capital outflows (led by

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*Financing of U.S. current account balances, October 1978–September 1979**
[Inflows (+) and outflows (-); $ billion]

	Fiscal 1978 (quarterly averages)	Fiscal 1979			
		Oct.-Dec. 1978	Jan.-Mar. 1979	Apr.-June 1979	July-Sept. 1979
Current account balance*	-4.7	1.1	1.7	-0.2	-3.1
U.S. reserve assets (increase (-))	.1	.2	-3.6	.3	2.8
Other U.S. Government assets*	-1.1	-1.0	-1.2	-.9	-.8
Foreign official assets	7.5	18.8	-9.4	-10.0	5.6
Industrial countries	7.8	16.8	-7.0	-11.6	4.0
OPEC members	-.4	1.8	-1.9	.2	1.5
Other countries	.2	.2	-.5	1.4	....
U.S. banks, net	-1.8	-14.4	13.7	3.8	-2.9
Claims	-4.9	-22.0	6.6	-8.3	-16.0
Liabilities[a]	3.1	7.6	7.2	12.1	13.0
Securities, net	....	1.2	2.3	.3	.1
Foreign securities	-.8	-.9	-1.1	-.6	-2.1
U.S. securities[a, b]	.9	[b]2.1	[b]3.4	.9	2.2
Direct investment, net	-2.4	-3.4	-5.0	-5.5	-4.8
U.S. investment abroad*	-3.9	-4.4	-6.0	-7.5	-7.2
Foreign investment in United States*	1.5	1.0	1.0	2.0	2.3
Other U.S. corporate capital, net	-.3	-2.1	-3.4	1.8	N/A
Claims	-.8	-1.9	-2.7	.7	N/A
Liabilities	.6	-.2	-.7	1.1	N/A
SDR allocations	....	....	1.1	....	....
Statistical discrepancy*	2.6	-.4	3.6	10.4	3.3

*All data are seasonally unadjusted, because capital flows except U.S. Government lending and reinvested earnings component of direct investment income are not available on seasonally adjusted basis.

N.A. Not available.

[a] Excluding foreign official assets.

[b] Includes Treasury issues abroad of foreign currency notes amounting to $1.6 billion in October-December quarter and $2.6 billion in January-March quarter.

Source: Survey of Current Business, June and December 1979, published by U.S. Department of Commerce, Bureau of Economic Analysis.

bank transactions) rose to a total of more than $20 billion—which was financed by nearly $19 billion of foreign official asset inflows plus some rundown of U.S. reserve assets. Over the remaining three quarters, recorded private capital (despite a reversal of the first-quarter banking outflow) showed a net outflow of $2.2 billion. This outflow plus a $2.9 billion outflow on Government lending, a $1.5 billion current account deficit, and a $14 billion runoff of foreign official assets were financed by a large positive statistical discrepancy.

Office of Statistical Reports

The Office of Statistical Reports manages two international financial statistics collection systems—the Treasury international capital (TIC) reporting system, and the Treasury foreign currency (TFC) reporting system.

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The TIC system collects monthly, quarterly, and semiannual data on U.S. banks' foreign assets and liabilities; U.S. commercial firms' claims on and liabilities to unaffiliated foreigners; and banks' and brokers' securities transactions with foreign residents. These data provide information on all movements of capital between the United States and foreign countries other than direct investment flows and Government transfers. Several of the reporting forms were extensively revised, effective in December 1978, to make them more useful for analytical and policy purposes. Also during fiscal 1979, the TIC staff prepared monthly analyses of foreign transactions in U.S. securities and periodic reports on U.S. banks' lending abroad.

In addition to providing data on an ad hoc basis to other Treasury offices and Government agencies, the TIC staff supply the capital movement data for monthly publication in the Treasury Bulletin, the Federal Reserve Bulletin, and for quarterly analysis and publication in the Department of Commerce's Survey of Current Business.

The TFC reporting system gathers information from banks and nonbanking business firms in the United States and their majority-owned foreign subsidiaries and branches on the assets, liabilities, and exchange contracts bought and sold in eight major foreign currencies and U.S. dollars held or owed by their foreign branches and majority-owned subsidiaries. Aggregate data are tabulated monthly in the Treasury Bulletin.

On October 29 and November 1, 1978, changes to the bank reporting forms became effective which significantly increased the analytical value of the weekly bank data while reducing the net reporting burden under the President's reporting burden reduction program.

A paper analyzing nonbanking firms' exchange market behavior was presented at the Southern Economic Association meeting, November 10, 1978.

Office of Data Services

The Office of Data Services provides computer and data processing facilities for the international affairs areas within the Office of the Secretary. Data Services also maintains and operates a computerized system for the collection and reporting of information on U.S. Government loans to foreigners.

The Office furnishes computer programming and technical advice services to other offices to enable them to efficiently process and analyze the large volumes of information associated with research in such areas as international capital flows, balance of payments forecasting, trade and international economic competition, and aid to the less developed countries.

Foreign Portfolio Investment Survey Project

The Foreign Portfolio Investment Survey Project is responsible for the collection and analysis of data relating to international portfolio investment and its effects upon the national security, commerce, employment, inflation,

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general welfare, and foreign policy of the United States. The Secretary of the Treasury was designated by the President as the Federal executive responsible for collecting these data mandated by the International Investment Survey Act of 1976 (Public Law 94-472, as amended). The act requires comprehensive surveys of both foreign portfolio investment in the United States and U.S. portfolio investment abroad.

On August 9, 1978, the Office of Management and Budget approved a survey of foreign portfolio investment in domestic securities as of December 31, 1978. Final survey regulations were published in the Federal Register on November 6. On November 8, over 10,000 survey questionnaires were mailed to banks, brokers, and corporations in the United States. Firms were asked to return the completed questionnaire by March 31, 1979.

A questionnaire was required to be filed by every U.S. issuer of securities which had total consolidated assets of $50 million if a nonbanking enterprise, of $100 million if a bank. However, a firm falling below these asset levels but with assets of $2 million or more was required to report if there was evidence of foreign ownership of its securities. Firms with assets less than $2 million were exempt from filing a questionnaire. In addition, a questionnaire was required from every U.S. entity acting as a holder of record of domestic securities on behalf of foreign persons if the combined market value of these securities, held for all foreign accounts, exceeded $50,000 as of December 31, 1978.

Most of the required questionnaires have been filed and are being reviewed, processed, edited, and tabulated. The report on foreigners' portfolio investment in the United States is scheduled to be completed in the fall of 1980.

As of July the required approvals were obtained from the Secretary and the Office of Management and Budget to establish a Foreign Portfolio Investment Advisory Committee comprised of public members from academia, the business and financial communities, and organized labor.

A feasibility study of alternative approaches to surveying U.S. residents' portfolio investment abroad was initiated. The last time such a survey was conducted was in 1943. The feasibility study was reviewed in draft form by the Advisory Committee on September 27 and is scheduled to be completed in the fall of 1979. Pending the results of the feasibility study, and congressional consultations, a determination will be made as to the design and implementation of an outward survey.

OFFICE OF THE GENERAL COUNSEL

The General Counsel, appointed by the President by and with the advice and consent of the Senate, is the chief law officer of the Department of the Treasury. As the chief law officer, the General Counsel administers the Legal

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Division, composed of all attorneys performing legal services in the Department and all nonprofessional employees providing support to the attorneys, and is responsible for all of the legal activities of the Department. This includes the legal staffs of all subordinate offices, bureaus, and agencies.

The General Counsel serves as the senior legal and policy adviser to the Secretary of the Treasury and other senior Treasury officials. He reviews the legal considerations relating to policy decisions affecting the management of the public debt, administration of the revenue and customs laws, international economic, monetary, and financial affairs, law enforcement, and other activities. Other responsibilities include providing general legal advice wherever needed, coordinating Treasury litigation, preparing the Department's legislative program and comments to Congress on pending legislation, reviewing the Department's regulations for legal sufficiency, and counseling the Department on conflict of interest and ethical matters. The General Counsel also is responsible for hearing appeals to the Secretary of the Treasury from administrative decisions of bureau heads or other officials.

In addition, the Office of Director of Practice (which regulates practice before the Internal Revenue Service) and the Office of Tariff Affairs (which administers the U.S. antidumping and countervailing duty laws) are under the supervision of the General Counsel.

The General Counsel manages the Legal Division through the Deputy General Counsel, the Assistant General Counsel for the Department, and the Chief Counsel and Legal Counsel of the various bureaus.

Legislation

During fiscal 1979, the General Counsel received some 1,400 requests and provided the Department's views to Congress and the Office of Management and Budget on about 1,000 bills, draft proposals, and legislation-related items concerning nontax matters. In addition, the Legal Division participated in drafting a number of legislative proposals which became law during this period. Among the more significant were:

1. Trade Agreements Act of 1979 (Public Law 96–39). The Department participated substantially in the drafting and the legislative process concerning this act which implemented the successful conclusion of the Tokyo Round multilateral trade negotiations. The act substantially amended the antidumping and countervailing duty laws.
2. Panama Canal Act of 1979 (Public Law 96–70).
3. Legislation to extend the direct purchase authority of Federal Reserve banks for 2 years (Public Law 96–18).
4. Legislation providing that the Exchange Stabilization Fund shall not be available for the payment of Department administrative expenses (Public Law 95–612), and authorizing appropriations therefor (Public Law 96–47).
5. Amendment of the Bretton Woods Agreements Act (Public Law 95–435).
6. Temporary debt ceiling increases (Public Laws 96–5 and 96–78).

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The Chief Counsel of the Bureau of Alcohol, Tobacco and Firearms substantially participated in drafting the Distilled Spirits Tax Revision Act of 1979 (title VIII, subtitle A, of the Trade Agreements Act of 1979). This act revises the method of imposing the excise taxes on distilled spirits whereby the distilled spirits tax would be determined solely on the basis of the proof gallons of alcohol contained in the product at the time of its withdrawal from the bonded premises of a distilled spirits plant; repeals the rectification taxes imposed on distilled spirits and wines rectified in the United States; adopts an all-in-bond system whereby the bonded premises of a distilled spirits plant are expanded to encompass all distilled spirits operations, including processing and bottling; eliminates the statutory requirement of joint custody of distilled spirits facilities requiring Treasury personnel be located on the premises of any distillery or facility where distilled spirits were produced or stored prior to payment of tax; and extends the time for payment of tax on distilled spirits bottled in the United States.

Litigation

The Legal Division is responsible for formulating the Department's position on litigation involving Treasury activities and for working with the Department of Justice in the preparation of litigation reports, pleadings, trial and appellate briefs, and assisting in trying all cases in which the Department is involved.

There are many thousand individual cases pending in the Customs Court, the Tax Court, and other Federal courts pertaining to Treasury functions.

In June 1979 the Supreme Court rejected an appeal in *O'Hair* v. *Blumenthal,* thus affirming the earlier dismissal by the U.S. district court and the U.S. Court of Appeals for the Fifth Circuit of plaintiffs' constitutional challenge to the statutes which require that the words "In God We Trust" be inscribed on all U.S. coins and currency.

In *Victor Guerra* v. *Eduardo Guajardo, District Director of Customs,* the U.S. Court of Appeals for the Fifth Circuit affirmed per curiam the district court's decision sustaining the authority of the Treasury to furnish information to Mexican customs officials concerning the exportation of commodities to Mexico pursuant to a mutual assistance agreement entered into by the U.S. and Mexican customs services.

In *Committee to Preserve American Color Television* v. *Blumenthal,* a trade association sought to compel the Customs Service to liquidate entries subject to the finding of dumping on Japanese television sets and to collect dumping duties in cash on such entries previously liquidated. The U.S. District Court for the District of Columbia dismissed the action on the ground that exclusive jurisdiction over the Customs Service lies in the Customs Court. The court found that section 516 of the Tariff Act of 1930 provided plaintiffs with a remedy and noted that the more desirable injunctive remedies sought by plaintiffs "are remedies which Congress advertently withheld." An appeal has been filed.

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In *Chasse* v. *Chasen,* five Customs inspectors claimed that a District Director violated an internal Customs Service circular on the assignment of overtime when he assigned WAE (when-actually-employed) employees to overtime in lieu of using full-time inspectors. They alleged that violation of the circular gave them a right enforceable at law, and sought damages for the lost income. The U.S. Court of Appeals for the First Circuit held that a Customs Service circular does not have the character of a regulation, and that the court lacks subject matter jurisdiction. A loss would have opened up numerous internal agency actions to judicial review.

In *Tran Qui Than* v. *Blumenthal,* the Treasury won a significant victory in a California U.S. district court, in defending the blocking under the Foreign Assets Control Regulations of assets of the largest South Vietnamese bank (prior to the takeover of that country by Communist forces in April 1975), against claims of refugee shareholders-directors. The court held that the act of state doctrine limitation on exterritorial recognition of expropriations could not be invoked as a bar to Treasury's blocking of the bank's assets, Vietnam not being a party to the action and the validity of the confiscation not being in issue. Thus, the case could not be distinguished from *Nielson* v. *Secretary of the Treasury,* 424 F2d 833 (C.A. D.C., 1970), a case involving Treasury's Cuban Assets Control Regulations, which was decided on similar grounds.

Regulations

During the fiscal year, the Chief Counsel for the Office of Foreign Assets Control prepared final regulations implementing the May 11, 1979, agreement between the United States and the People's Republic of China which provided for unblocking of Chinese assets on January 31, 1980. Final regulations were also prepared which require all persons holding certain types of blocked property in which China, Cuba, North Korea, Vietnam, Cambodia, or their nationals had an interest, as well as certain property blocked since World War II, to hold such property in interest-bearing accounts in domestic banks. The regulations also imposed a reporting requirement on all persons holding blocked assets subject to the new interest regulations.

The Department's various bureaus prepared internal rules and procedures implementing the Right to Financial Privacy Act of 1978.

Other matters

The Office participated in legal and policy discussions with respect to Chrysler Corp.'s request for Federal financing assistance.

The Office also participated in the administration of the New York City Financial Assistance Act.

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ENFORCEMENT AND OPERATIONS

The Assistant Secretary (Enforcement and Operations) was assisted by two deputies and their staffs in the oversight and supervision of four operating bureaus: U.S. Customs Service, U.S. Secret Service, Federal Law Enforcement Training Center, and Bureau of Alcohol, Tobacco and Firearms. The policies and operations of the Office of Foreign Assets Control were also under the purview of the Assistant Secretary.

The Office of Operations continued to be primarily concerned with the zero-base-budget objectives program emphasizing quarterly review sessions with the bureaus, cost-effective execution of programs, productivity improvements, equal employment opportunities, legislative review, and various policy issues regarding the bureaus.

As a result of an analysis made by Office of the Secretary staff, the Deputy Assistant Secretary (Operations) approved closing the Customs Car Barn training site and moved Customs inspector training to Glynco, Ga., for an estimated $1.7 million one-time savings to the Government. The Office of Operations discontinued providing staff support to the Under Secretary in the supervision of the Bureaus of the Mint and Engraving and Printing after a staff position was established in the Office of the Under Secretary to handle those responsibilities.

The staff of the Deputy Assistant Secretary (Enforcement) continued its review of policies and standards under which Treasury law enforcement personnel perform their duties. Guidelines on the use of force were completed. In addition, guidelines on the development and use of informants and undercover operations will be completed by January 1980. The Office of Foreign Assets Control has been involved in implementing the Agreement Concerning the Settlement of Claims between the Government of the United States and the Government of the People's Republic of China. This agreement resulted from the normalizing of relations with China in January 1979.

The activities of each of the bureaus and the Office of Foreign Assets Control are recorded in the "Administrative Reports" section of this volume.

Alcohol

Treasury has continued to review the way the alcoholic beverage industry is regulated in order to eliminate unnecessary regulations, clarify or bring up to date any old but necessary regulations, and develop legislative proposals which will be needed to improve the system. Two areas of special concern have been the regulation of the trade practice and advertising areas. Treasury also studied the issue of a warning label for alcoholic beverages alerting pregnant women about the possibility that alcohol can cause birth defects. After consulting with expert scientists, Treasury decided to launch a public

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awareness campaign with the cooperation of industry members rather than require a warning label.[1] The campaign has resulted in public service announcements for television, advertisements in women's magazines, pamphlets, posters, materials for schools, and other activities—paid for jointly by industry, Treasury, and the Department of Health, Education, and Welfare. On another labeling-related issue, Treasury also proposed regulations which would require partial ingredient labeling on alcoholic beverages. The full range of regulatory possibilities, including costs and benefits of each, is now being analyzed as part of a regulatory analysis.[2]

All-in-bond

The Distilled Spirits Tax Revision Act of 1979, enacted to approve and implement the trade agreements negotiated under the Trade Act of 1974, establishes an all-in-bond system of control for distilled spirits plants. Two major changes in distilled spirits control will result after implementation commences on January 1, 1980. First, the tax system will be changed to eliminate the disparities between domestic and imported spirits from joint custody to all-in-bond. Second, ATF will have the latitude and authority to discontinue the assignment of Government officers at distilled spirits plants.

In preparation for implementation, ATF has prepared interim regulations for the establishment of new tax procedures and payments while insuring protection of the revenue. This has required extensive planning, consultation with industry representatives, personnel training, and revision of regulations. The effort will continue with the objective of completing implementation by the end of fiscal 1984.

Bank Secrecy Act of 1970

The Assistant Secretary (Enforcement and Operations) has the responsibility for administering the Treasury regulations (31 CFR part 103) that were issued to implement the Bank Secrecy Act (titles I and II of Public Law 91-508). The regulations require banks and other financial institutions to maintain certain basic records that have a high degree of usefulness in the investigation of tax, regulatory, or criminal matters.[3] The regulations also contain the following reporting requirements:

(1) Financial institutions must report to the IRS any unusual domestic currency transaction in excess of $10,000. (IRS form 4789)

(2) Travelers and others must report to the Customs Service the international transportation of currency and certain other monetary instruments in excess of $5,000. (Customs form 4790)

(3) U.S. firms and individuals must report their financial interest in or their control over foreign bank and other financial accounts. (Treasury form 90-22.1)

[1] See exhibit 26.
[2] See exhibit 28.
[3] See exhibits 30 and 37.

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Responsibility for assuring compliance with the regulations is shared by the Federal bank supervisory agencies, the Securities and Exchange Commission, the Federal Home Loan Bank Board, the National Credit Union Administration, the IRS, and Customs, under general oversight of the Assistant Secretary (Enforcement and Operations).

This year the Department continued its efforts to upgrade the level of compliance with the regulations and to improve the utilization of the information available from the required reports. The Department has asked the bank supervisory agencies to make certain changes in their examination procedures and to provide appropriate training for examiners who actually inspect banks for compliance with the regulations. In September 1979, the Department published for comment a proposed amendment to the regulations (31 CFR part 103) governing the reporting of currency transactions which will add to the effectiveness of the requirement.

The Reports Analysis Unit, established in July 1978 to analyze and disseminate information from the forms 4789, 4790, and 90-22.1, was incorporated into the Customs Service in April 1979. The Commissioner of Customs was delegated authority to release information to other Federal agencies. The IRS has continued to contribute resources to the Unit.

After consultation with the Commissioner of Internal Revenue, the requirement to report foreign financial accounts was changed to exempt persons who had accounts totaling $1,000 or less. Reports of such accounts appear to be of limited value to law enforcement or regulatory agencies, and their elimination has reduced the paperwork burden on the public.

The Federal Deposit Insurance Corporation began a program to inspect all uninsured domestic offices of foreign banks doing business in the United States for compliance with the regulations. Although the majority of those offices were inspected during the year, no flagrant violations were reported.

During the year, 121,000 forms 4789, 59,000 forms 4790, and 101,000 forms 90-22.1 were filed with the Department. The Reports Analysis Unit provided the Drug Enforcement Administration with 2,135 reports reflecting $228 million in domestic currency transactions and 283 reports pertaining to the international transportation of currency and other monetary instruments amounting to $25 million that appeared to be related to illegal drug activity. A substantial number of reports were also furnished to various Federal investigative agencies. The Customs Service made 1,173 seizures of unreported monetary instruments totaling more than $19.8 million. There were 44 convictions resulting from Customs' investigations of criminal violations of the reporting requirements.

In connection with its efforts to improve enforcement of the Bank Secrecy Act, the Department analyzed currency transactions at Federal Reserve offices throughout the United States during 1978. The study disclosed a very unusual flow of currency in Florida during a period when the Federal Reserve bank offices in the State had an excess of receipts and removed more than $3.2 billion from circulation. This trend continued into 1979. The surplus

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for 1979 amounted to approximately $4 billion by the end of September. The study also indicated an unusual outflow of $100 bills in the New York Federal Reserve office. The Department has initiated further inquiries into the transactions in Florida and New York to determine if they in some way reflect violations of the Bank Secrecy Act.

Counterterrorism

Treasury has continued its active participation in the Executive Committee on Terrorism of the National Security Council's Special Coordination Committee and in interagency Federal security planning for special events. Treasury and its enforcement agencies were heavily involved in the security planning for the 1979 Pan American Games in Puerto Rico, and they are continuing this role in preparation for the 1980 Winter Olympics in Lake Placid, N.Y.

Gasohol

The Energy Tax Act of 1978 instructed the Secretary of the Treasury to furnish to Congress recommendations simplifying and expediting statutory requirements for those desiring to produce alcohol for use as a fuel (gasohol). Treasury, working with Members of Congress, developed legislation introduced in May.[4] Congress has included the Department's legislation as an amendment to the windfall profits tax bill.

This legislation is designed to assist the relatively small producers such as farmers and farm cooperatives. As the administrative action plan of the legislation indicates, Treasury will vary the regulatory requirements covering security, bonding, and recordkeeping depending on the production level of the alcohol producer. Irrespective of the production level, all alcohol will have to be denatured with approved additives to destroy the alcohol's beverage character.

As an interim measure until legislation is passed by Congress, Treasury is issuing permits that authorize certain small noncommercial producers to operate as experimental plants. While these permits do not allow sales or exchanges and are limited to 2 years, other regulatory requirements are minimized under an experimental permit. To further eliminate impediments to gasohol production, the Department has reduced the bond requirement to $100 annually for alcohol producers producing 2,500 gallons or less. In addition, Treasury is attempting to liberalize denaturing formulas in order to allow gasoline alone to satisfy the requirement for an additive, thus eliminating a need for chemical denaturants.

Preclearance

During the Treasury appropriation hearings in the 95th Congress, the House and Senate requested the Department of the Treasury to initiate a

[4] See exhibit 36.

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complete study of the aviation preclearance program. Treasury, in concurrence with the Immigration and Naturalization Service (INS) and the Animal and Plant Health Inspection Service (APHIS), provided the requested analysis to Congress in February. The analysis delineated the benefits and costs of this program to the U.S. Government, U.S. airlines, passengers, and the host government.

In general, the analysis recognized the need to carefully evaluate preclearance programs on a case-by-case basis. While preclearance does help to relieve the congestion at U.S. airports, there are substantial costs, particularly to Customs in loss of staff-hours since inspectors at preclearance sites screen passengers only. However, American air carriers, INS, and APHIS receive significant benefits. Air passengers, especially frequent travelers routed beyond gateway airports, also experience benefits such as limited delays.

As part of the 1974 United States-Canadian Preclearance Agreement, the Department completed its plans to open an interim preclearance operation at Edmonton, Alberta. This facility will operate until May 1981 when Canada will open the permanent facilities. With the continued economic growth of the western Canadian cities such as Edmonton and Calgary, the two latest preclearance facilities will grow in importance and significantly help to relieve airport congestion in the United States.

Another procedure which expedites passenger processing and reduces congestion at airports is the Department's new one-stop inspection. "One-stop" is a procedure in which Customs, INS, and APHIS share the responsibility of primary inspection so that the average passenger is questioned by only one inspection officer. Thereby, the responsibilities of all three Federal services are handled with reduced staffing requirements. The Canadians have accepted the one-stop concept and are incorporating it into the permanent Edmonton facilities and their plans for remodeling the Winnipeg facilities.

Regulatory policy and trade affairs

Increased focus on regulatory policy and trade affairs continued during the year. Executive Order 12044 (March 23, 1978) and the Treasury plan implementing that order established new procedures for agency rulemaking, and mandated that regulations be as simple and clear as possible, that they achieve legislative goals effectively and efficiently, and not impose unnecessary burdens on the economy, on individuals, or private or public sector organizations. The Office of the Assistant Secretary (Enforcement and Operations) continued working with the bureaus supervised to implement these new procedures and policy directives.

Substantively, major regulatory activity included implementation of the International Customs Valuation Code and ATF's all-in-bond tax administration system, the Customs Procedural Reform and Simplification Act of 1978 (Public Law 95-410, October 3, 1978), and various alcoholic beverage labeling proposals. All Customs and ATF regulatory proposals, as well as

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major civil penalty cases, were reviewed for consistency with established policies.

TAX POLICY

Legislation

The Revenue Act of 1978.—On January 21, 1978, the President proposed major tax reform to make the tax system more efficient, tax burdens more equitable, and tax rules simpler. In addition, tax reductions were proposed to sustain purchasing power, and to provide business with incentives to invest in more and better facilities, and to create jobs. Congressional consideration of these proposals subsequently led to the Revenue Act of 1978 (Public Law 95-600), enacted November 6, 1978, and generally effective January 1, 1979.

This act reduced taxes for individuals and businesses, and included several of the administration's 1978 tax reform proposals. In the absence of this act, receipts would have been increased substantially in 1979 because several temporary provisions of the Tax Reduction and Simplification Act of 1977 were scheduled to expire at the end of calendar 1978.

The act provided new tax cuts of $21.3 billion in calendar 1979. In addition, the extension of previously expiring cuts provided an additional reduction of $13.5 billion. In total, then, the Revenue Act of 1978 provided $34.8 billion of tax cuts for calendar 1979.

Individual income taxes.—The Revenue Act of 1978 provided three principal individual income tax cuts affecting virtually all taxpayers. The act increased the personal exemption from $750 to $1,000 beginning in 1979, replacing the temporary general tax credit which equaled the greater of $35 for each exemption or 2 percent of the first $9,000 of taxable income in excess of the zero bracket amount. The act replaced the tax rate schedule, which formerly had 25 brackets, with a new schedule with 15 wider brackets. Also, it increased the zero bracket amount and the corresponding floor under itemized deductions (which had replaced the old standard deduction) from $2,000 to $2,300 for single persons, and from $3,200 to $3,400 for married couples. The act significantly expanded the earned income credit and simplified it so that it will be easier to compute. Finally, instead of being paid out as one lump sum upon filing a tax return for the taxable year, the credit will be reflected in employees' paychecks, making it a more effective work incentive and distributing the tax relief more evenly throughout the year. These cuts for individuals reduced calendar 1979 liability by $14.1 billion—about 40 percent of the total for the entire act.

Capital gains taxes were reduced significantly by the 1978 Revenue Act. Under previous law, 50 percent of net long-term gains from the sale of capital assets were excluded from taxable income. Alternatively, taxpayers could

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elect to be taxed at a 25-percent rate on the first $50,000 of gains if that tax was lower than would otherwise apply. Under the new legislation, which applies to gains and losses realized after October 31, 1978, the percentage of capital gains excluded from taxable income was raised to 60 percent. However, for tax years beginning after December 31, 1978, the 25-percent alternative tax was eliminated. Also, the excluded 60 percent of net long-term capital gains is included as a preference item in computing a new alternative minimum tax, payable if the minimum tax liability exceeds the ordinary tax liability. For taxpayers age 55 and older, the act also provides a once-in-a-lifetime exclusion on gains of up to $100,000 realized on the sale of their principal residence.

Significant changes in the tax treatment of accrued capital gains on property passing from decedents to estates or other heirs were included in the Tax Reform Act of 1976. The income on a sale of property generally is measured by the difference between its cost (basis) and selling price. However, prior to 1977, the basis of property passing from a decedent was "stepped up" to its value at the time of death. Thus, any increase in value during the decedent's lifetime was never taxed. The Tax Reform Act of 1976 revised this treatment for decedents dying after December 31, 1976, whereby the heir would have to use a "carryover basis"; i.e., income from a subsequent sale by the heir would be measured by the difference between its selling price and the asset's initial cost to the decedent. The Revenue Act of 1978 postponed the effective date of the carryover basis provisions so that they apply only to property passing from decedents dying after December 31, 1979.[1] The postponement also would facilitate administration of the carryover basis provision by exempting many more smaller estates from its effect and by simplifying the transitional rules and the adjustment for death taxes. This deferral of the carryover basis rules reduced calendar 1979 liability by $93 million.

These and other tax reductions were partially offset by higher receipts from reform measures in the Revenue Act. The two most significant reforms were repeal of the nonbusiness deduction for State and local gasoline taxes and the taxation of unemployment compensation benefits paid to taxpayers with adjusted gross incomes (including unemployment compensation) above $20,000 for single taxpayers and $25,000 for married couples filing joint returns. These two provisions increased tax liability by $1.4 billion in calendar 1979.

Business income taxes.—The Revenue Act of 1978 also made several significant changes to business and corporation income taxes. The act provided a sizable reduction in the corporate income tax rate. The top corporate tax rate was reduced from 48 percent to 46 percent, and a system of graduated tax rates was established for smaller corporations. In place of rates of 20 percent on the first $25,000 of taxable income, 22 percent on taxable

[1] See exhibit 39.

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income between $25,000 and $50,000, and 48 percent on taxable income in excess of $50,000, the new rate schedule is 17 percent on the first $25,000 of income, 20 percent on income between $25,000 and $50,000, 30 percent on income between $50,000 and $75,000, 40 percent on income between $75,000 and $100,000, and 46 percent on income above $100,000. This tax reduction, amounting to about $5 billion in 1979, is designed to increase business investment and encourage the formation and expansion of small businesses. About $1 billion of the tax cut will be received by businesses with incomes below $100,000.

For business in general, the investment tax credit, which had been scheduled to decline from 10 percent to 7 percent on January 1, 1981, was made permanent at the 10-percent rate.[2] The percentage of tax liability that can be offset by the investment credit was also increased from 50 percent to 90 percent. The additional offset is to be phased in over a 4-year period at an additional 10 percentage points each year beginning with taxable years that end in 1979 (i.e., 60 percent in 1979, 70 percent in 1980, and so forth).

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978 equal to 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The 1977 credit had several limitations and did not seem to be providing the employment incentives envisioned by Congress. Therefore, when considering the Revenue Act of 1978 Congress decided to focus employment incentives on those individuals who have special difficulty getting a job even when the national unemployment rate is low.

Therefore, it was decided to let the 1977 new jobs credit expire at the end of 1978. In its place, Congress designed a provision to provide an incentive for private employers to hire individuals in several "target groups." The targeted individuals included vocational rehabilitation referrals, economically disadvantaged youths, economically disadvantaged Vietnam-era veterans, supplemental security income recipients, general assistance recipients, youths participating in a cooperative education program, and economically disadvantaged ex-convicts. The new targeted jobs credit reduced liability by about $400 million in 1979.

The Energy Tax of 1978.—This legislation (Public Law 95-618) was enacted on November 9, 1978. It is an important part of the national energy program enacted in 1978, and is intended to reduce this country's reliance on uncertain foreign energy supplies.[3] The major features of the 1978 energy tax legislation are:

- A tax on the sale of automobiles whose fuel economy fails to meet certain standards;
- Tax credits for purchases of insulation and other energy-conserving items for the principal residence of a taxpayer;

[2] See exhibit 40.
[3] See exhibit 55.

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- Credits for renewable energy source equipment (e.g., solar and wind energy equipment) on the principal residence of a taxpayer; and
- For businesses, an extra 10-percent investment credit (in addition to the regular 10-percent credit) for certain energy conservation or conversion investments.

This legislation is expected to reduce tax liability by $0.8 billion in calendar 1979.

The Foreign Earned Income Act of 1978.—Prior to 1978, a U.S. citizen generally could exclude up to $20,000 per year of foreign earnings if the taxpayer was a bona fide resident of a foreign country. After 3 years of foreign residence, a taxpayer could exclude up to $25,000 per year of foreign earnings. The Foreign Earned Income Act of 1978 (Public Law 95–615, signed by the President on November 8, 1978, replaced the former exclusion provision with a new one based on the excess cost of living abroad. Under the new law, the taxpayer may claim a cost-of-living deduction to reflect the amount by which overseas living costs (other than housing and education) exceed living costs for the most expensive metropolitan area in the Continental United States (except Alaska) as determined by the Internal Revenue Service. Other deductions are permitted for the excess costs associated with housing, dependents' elementary and secondary education, and annual home leave for the taxpayer and dependents, and for employment in certain hardship areas. This act will reduce tax liability by $0.2 billion in fiscal 1979.

Revision of miscellaneous timing requirements.—This law (Public Law 95–628) was enacted November 10, 1978. It contains provisions relating to the time for (1) payment of expenses owed to related parties; (2) election of special corporate liquidation treatment where there has been an involuntary conversion; (3) election of Subchapter S status by a corporation; (4) filing of unrelated business income tax returns for exempt organizations; (5) determining the status of a taxpayer as a farmer or fisherman for estimated income tax purposes; and (6) undertaking other miscellaneous transactions.

Legislative proposals

Real wage insurance.—In October 1978 as part of his anti-inflation program, the President proposed a "real wage insurance" tax credit.[4] The purpose of real wage insurance was to encourage compliance with the wage standard administered by the President's Council on Wage and Price Stability. Under this proposal, groups of employees whose compensation increase for the year was generally within the anti-inflation guidelines would have been eligible for the tax credit if inflation exceeded 7 percent on an annual basis.

The rate of the credit was to be equal to the difference between the percentage increase in the Consumer Price Index over the applicable period (October–November 1978 to October–November 1979) and 7 percent, with a

[4] See exhibit 38.

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maximum credit of 3 percentage points. The credit would have applied to qualified wages up to a limit of $20,000 from any one employer. Since the credit was intended to replace wages and salaries, it would have been included in the employee's taxable income.

As of the end of fiscal 1979, this legislation had not been reported out of the House Ways and Means Committee.

The windfall profits tax.—In April 1979, the administration announced that it intended to use its discretionary authority over oil prices to phase out petroleum price controls between June 1, 1979, and October 1, 1981, when the existing control authority expires. These controls now hold down our domestic production, encourage consumption, and increase our dependence on foreign oil. In addition, as controls end and prices rise, oil companies will reap billions of dollars of windfall profits.

To capture the excess profits that will result from the phased decontrol of U.S. oil prices, the President proposed enactment of a 50-percent windfall profits tax. This would be an excise tax imposed on domestic production of crude oil and would become effective on January 1, 1980.

The windfalls recaptured by the tax would be earmarked for energy-related uses. Until decontrol is completed, the tax would affect windfall profits associated with: Decontrol of lower tier oil (also called old oil); decontrol of upper tier oil, now price controlled at about $13 per barrel; and additional revenues which oil producers would receive if the world market price of oil increases in real terms.

It was estimated that the windfall profits tax would raise $2.9 billion in fiscal 1980 and $9.3 billion in fiscal 1981 for financing an energy security trust fund. This fund would have three major purposes: (1) To provide assistance to low-income households who can least afford energy price increases; (2) to increase funding for mass transit; and (3) to fund energy research and development.

The House of Representatives in June 1979 passed H.R. 3919, the Crude Oil Windfall Profits Tax Act of 1979. The bill was then sent to the Senate Finance Committee where it was under consideration at the end of fiscal 1979.

Other proposals.—The administration proposed several other measures to improve resource allocation and the overall efficiency and equity of the tax structure. The principal ones are described briefly below.

Cash management measures.—The fiscal 1980 Federal receipts estimates reflect several initiatives that would alter the timing of tax payments, generally requiring taxpayers to make income tax payments closer to the time when their liabilities occur and requiring employers to deposit taxes withheld from employees on a more timely basis. These initiatives would increase liability by $2.2 billion in 1980 and $4.8 billion in 1981.

These proposals include provisions relating to:

- State and local deposits of social security taxes which would place such governments on a basis more like that of private employers;

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- Employer deposits of withheld income and payroll taxes which would accelerate the time by which deposits of large employers must be made while giving relief to an estimated 1.5 million smaller employers;
- Individuals' payments of estimated taxes so that people whose liabilities are paid as estimated taxes can no longer pay their taxes substantially later than those whose liabilities are satisfied through withholding.

Corporations now are generally required to pay only 80 percent of their current-year tax liability through estimated payments during the year. The proposed measures affecting cash management of corporations include: (1) Raising the required level of estimated payments from 80 percent to 85 percent; requiring full payment of any remaining liability for the prior calendar year in a single payment on March 15 of the succeeding year (rather than in two payments as is now the case); and modifying the existing provision that allows corporations to make estimated payments on the basis of their prior-year tax liability (a corporation that paid no tax last year would not be liable for any estimated tax payments in the current year). Also, large corporations would be required to make current-year payments that are at least 60 percent of their current-year liability.

While Congress was not able to consider the cash management proposals in fiscal 1979, the Treasury still continues to work for their enactment.

Tax distinction between employees and independent contractors.—A worker gets favorable withholding and social security tax treatment from being classified as an "independent contractor" rather than as an "employee." And under current law, there is no clear way to distinguish between these two groups of people. As a result, this distinction has become a frequent source of controversy between taxpayers and the Internal Revenue Service. Therefore, in fiscal 1979 the administration proposed legislation to clarify this distinction, to impose a 10-percent flat withholding rate on the gross receipts of some independent contractors, and to strengthen information reporting requirements for others.[5] This proposal has not yet been acted upon by Congress.

Airport and airway trust fund taxes.—These taxes generally are scheduled to expire on June 30, 1980. The administration proposed legislation in the fiscal 1980 budget to extend the current freight waybill and passenger ticket taxes, and certain other taxes at their present rates. The legislation would also change the current 7-cents-per-gallon tax on aviation fuel to an ad valorem tax of 10 percent of its price. A new 6-percent tax on new aircraft and avionics was proposed to become effective October 1, 1980. At the end of fiscal 1979, Congress had not completed action on this legislation.

[5] See exhibit 43.

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Administration, interpretation, and clarification of tax laws

During fiscal 1979, 66 final Treasury decisions, 13 temporary Treasury decisions, and 64 Treasury notices of proposed rulemaking were published in the Federal Register. A substantial number of these publications implemented provisions of the Revenue Act of 1978 and the Tax Reform Act of 1976. Typical items included regulations relating to the investment tax credit for movie films; public inspection of IRS determinations; requirements to obtain a ruling from the IRS relating to foreign corporations; and information regarding carryover basis property acquired from a decedent.

Publications

Tax reports.—Pursuant to various congressional and other requirements, the Treasury published the following reports in fiscal 1979:

"Federal Tax Policy and Recycling of Solid Waste Material," February 1979.

"The Operation and Effect of the International Boycott Provision of the Internal Revenue Code, 1st Annual Report," March 1979.

"The Operation and Effect of the Domestic International Sales Corporation Legislation," the 1977 annual report, April 1979.

"Taxation of Foreign Investment in U.S. Real Estate," May 1979.

"The Operation and Effect of the Possessions Corporation System of Taxation," the second annual report, June 1979.

Tax research.—In 1979, the Treasury published the "Compilation of OTA Papers," Vol. 1, which brought together OTA Papers, Nos. 1–25, a series of studies sponsored by the Office of Tax Policy on the effects of the tax system on the economy. In addition, the following new OTA papers were published in 1979:

Seymour Fiekowsky, "Accounting for Tax Subsidies With Special Reference to Cost of Service, or 'Fair Rate of Return,' Utility Regulation," May 1979 (OTA Paper No. 27).

John Mutti, "The American Presence Abroad and U.S. Exports," October 1978 (OTA Paper No. 33).

Benjamin Okner, "Distributional Aspects of Tax Reform During the Past 15 Years," October 1978 (OTA Paper No. 35).

Larry Dildine and Eric J. Toder, "Effects of Potential Tax Reforms on Stock Market Yields," April 1979 (OTA Paper No. 36).

Eugene Steuerle, "Adjusting Depreciation for Price Changes," March 1979 (OTA Paper No. 37).

Eugene Steuerle, "Tax Expenditures for Health Care," April 1979 (OTA Paper No. 38).

Tax treaties

Income tax treaty negotiations continued with Australia, Bangladesh, Canada, Jamaica, Malta, Tunisia, and West Germany in fiscal 1979. Treaties

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were initialed with Bangladesh and Malta. Negotiations were held on amendments to previously concluded income tax treaties with Egypt, Israel, Norway, the Soviet Union, and the United Kingdom. Protocols with Israel and the Soviet Union were initialed. Income tax treaty negotiations were begun with Argentina, Costa Rica, and Nigeria. The negotiations with Nigeria were begun subsequent to the termination by Nigeria, effective in 1979, of the existing treaty between Nigeria and the United States. Estate tax treaty negotiations were continued with West Germany.

An income tax treaty with Hungary was signed on February 12, 1979. A protocol to the pending income tax treaty with the United Kingdom was signed on March 15, 1979, and a protocol to the income tax treaty with France was signed on November 24, 1978. Estate tax treaties with France and the United Kingdom were signed on November 24, 1978, and October 19, 1978, respectively.

On July 9, 1979, the Senate gave its advice and consent to the ratification of income tax treaties with Hungary and Korea, a protocol to the existing income tax treaty with France, a protocol to the proposed income tax treaty with the United Kingdom, and estate tax treaties with France and the United Kingdom. Instruments of ratification were exchanged during September 1979 with respect to the income tax treaties with Hungary and Korea and protocol to the income tax treaty with France.

In June 1979, the Treasury announced its intention to renegotiate the existing income tax treaty with the Netherlands Antilles. A similar announcement was made in August 1979 with respect to a number of United Kingdom territories and former territories to which the U.S. treaty with the United Kingdom was extended in 1959.

Participation in international organizations

Treasury representatives participated in the work of the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development (OECD), including membership on a number of working parties of the Committee. Treasury representatives also participated in the U.N. Group of Experts on Tax Treaties between Developed and Developing Countries.

Treasury representatives also meet annually with tax authorities from the United Kingdom, the Federal Republic of Germany, and France to study more effective methods of avoiding double taxation, simplification of arrangements for the assistance of taxpayers through mutual consultation, and the exchange of tax-related information.

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INTERNATIONAL AFFAIRS

Trade and Investment Policy

Trade negotiations

Much of the work in the trade area during fiscal 1979 was devoted to the successful conclusion of the multilateral trade negotiations (MTN) in Geneva. In April 1979, the United States and 24 other countries signed a proces-verbal covering the texts of agreements on subsidies and countervailing measures, antidumping, customs valuation, product standards, government procurement, and licensing. In June 1979, an additional protocol was signed covering tariff concessions. Signature of these documents formally concluded the negotiating phase of the MTN.

Extensive consultations with Congress were held throughout the spring to develop legislation to implement in U.S. law the new obligations negotiated in the MTN. The Trade Agreements Act of 1979 was approved overwhelmingly by Congress and signed into law by the President on July 26, 1979. It provides the basis for formal signature of the MTN agreements in the late fall of 1979.

Treasury concentrated its efforts on the Agreement on Subsidies and Countervailing Measures, one of the key elements in the MTN package.[1] For the United States, this code marks the first major step to slow the growth of government intervention in trade through the use of subsidies.

In the development of the code, Treasury focused on the need for precise rules governing the use of export subsidies and improved discipline over all subsidies having an impact on trade. Export subsidies for industrial products and minerals are prohibited. This provision is complemented by an expanded, illustrative list of prohibited export subsidy practices. New and more precise rules were incorporated to control the use of export inflation insurance and exchange risk guarantee schemes, duty drawbacks, and export performance requirements. New limits were also placed on agricultural export subsidies to protect U.S. export markets. To enforce this new discipline, dispute settlement procedures have been expedited to ensure prompt action against code violations. The United States in turn agreed to the inclusion of an injury test in our countervailing duty law—one of the major objectives of our trading partners in the MTN.

One of the key achievements of the MTN subsidies code is the agreement by developing countries to phase out the use of export subsidies over time, commensurate with their competitive and development needs.[2] Developing countries in the past have not been under the discipline of section B of GATT Article XVI. The code contains procedures for the assumption over time by developing countries of all GATT obligations on export subsidies. This is an important step toward the closer integration of developing countries in the world trading system.

[1] See exhibit 47.
[2] See exhibit 72.

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The foundation for participation by developing countries in the MTN subsidies code was laid through a series of extensive consultations with key developing countries. In November 1978, Treasury Assistant Secretary Bergsten negotiated a comprehensive agreement with Brazil on subsidy/countervail issues. As part of the terms for a waiver of countervailing duties on Brazilian textiles, the United States and Brazil worked closely with other developing countries to develop special code provisions for developing countries on the use of export subsidies. For its part, Brazil instituted in January 1979 a program to phase out its export subsidy program by June 30, 1983. [Brazil signed the code in December 1979 and, during that month, decided to eliminate immediately its major export subsidies.]

Throughout the second half of calendar 1979, consultations were held with other developing countries with major trading interests to encourage their accession to the MTN subsidies code.[3] [The subsidies code entered into force on January 1, 1980.]

In recognition of the importance of exports to the U.S. economy as a whole, the administration also adopted a number of measures designed to encourage exports and minimize Government-induced export disincentives.[4] Of greatest importance has been the expanded budget support for the Export-Import Bank of the United States as a means of increasing official assistance to U.S. exports. (See further discussion on export credits.)

East-West trade

U.S. trade with Communist countries, following an upward trend in 1978, continued to increase in 1979. During the first 9 months of 1979, the United States imported $1.7 billion in products from Communist nations and exported to them $4.9 billion in U.S. goods.

In December 1978, Secretary Blumenthal cochaired the seventh session of the Joint U.S.-U.S.S.R. Commercial Commission and addressed a session of the U.S.-U.S.S.R. Trade and Economic Council in Moscow.

Following the Moscow meeting, Secretary Blumenthal traveled to Romania as President Carter's special envoy to demonstrate U.S. support for Romania's independent policies. While there, the Secretary met with President Ceausescu and other prominent Romanian officials.

In February, Secretary Blumenthal led an official delegation to China. The trip resulted in the successful negotiation of a claims/assets agreement and the establishment of the U.S.-China Joint Economic Committee, with Secretary Blumenthal designated as the U.S. cochairman.[5]

During the summer of 1979, President Carter's request to extend the emigration waiver authority for 1 year for Romania and Hungary under

[3] See exhibit 75.
[4] See exhibits 46, 49, and 50.
[5] See exhibits 45 and 52.

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section 402 of the Trade Act of 1974 was approved, when neither House of Congress voted against extension.[6] The Romanian Trade Agreement also was extended for 3 more years.

Export credits

During the fiscal year, Treasury representatives led U.S. delegations to various multilateral meetings on export credits in the framework of the Organization for Economic Cooperation and Development (OECD) and to bilateral meetings discussing export credit policies and practices. A prime objective of these discussions was to achieve further improvements in the International Arrangement on Export Credits. However, wide differences between the U.S. Government and the European Economic Community, in particular, resulted in a temporary suspension of negotiations.

Participants in the International Arrangement launched an interest rate study in recognition of the fact that the interest rate matrix is a key element in the effort to avoid self-destructive competition in the export credit area. That study will be completed by the end of 1979 and should provide a basis for developing more realistic provisions on minimum interest rates and other practices in the export financing area which create unfair competitive advantages.

The United States believes that the Arrangement remains a useful, if limited, instrument of international discipline in the provision of officially supported export credits. Pending further improvements in the Arrangement, however, and to assure that U.S. exporters do not suffer from the forms of subsidies provided by other official export credit agencies, the Export-Import Bank of the United States (Eximbank) has been providing more aggressive export financing support to U.S. exporters.[7]

The Export-Import Bank's direct loan budget in fiscal 1980 is $500 million more than in fiscal 1979. The Bank increased its percentage of cover from around 40 percent of export value to over 60 percent in fiscal 1979. It held down its interest rates, while dollar interest rates in the private market and the cost of money to the Bank continued to rise. In support of U.S. aircraft manufacturers, the Bank met the generous financing offers made by the Governments of France and Germany in support of Airbus. Eximbank also matched mixed credits of France and the United Kingdom on a selective basis, as necessary to maintain a competitive position for U.S. exporters.[8]

Treasury also continued to review the export program of the Commodity Credit Corporation (CCC), providing advice to the Agriculture Department both directly and through the National Advisory Council on International Monetary and Financial Policies. Programs that benefited from this advice included the noncommercial risk assurance program (GSM–101) and the

[6] See exhibit 77.
[7] See exhibit 48.
[8] See exhibit 50.

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intermediate-term (3 to 10 years) credit program authorized by the Agricultural Trade Act of 1978.

The GSM-101 program involves assurance for U.S. agricultural exporters and financial institutions against a host of noncommercial risks, thereby providing incentives for greater private market financing of U.S. agricultural goods. The intermediate credit program authorizes significantly longer credit terms to foreign importers of selected categories of U.S. agricultural goods such as breeding animals. The CCC budget for financing agricultural exports was $1.6 billion in fiscal 1979.

The United States provided in excess of $5.6 billion of foreign military sales credit financing as part of its security assistance program to 26 countries during fiscal 1979, up from $2.1 billion in fiscal 1978. The large increase was primarily in credits for Israel ($3.2 billion) and Egypt ($1.5 billion), which now account for more than 80 percent of the entire credit program. Almost $5.2 billion of this financing was provided by the Federal Financing Bank.

Treasury officials also expressed concern about the increased foreign use of offset and coproduction requirements as part of large-scale coproduction or reciprocal procurement programs in the defense area.

Investment incentives and disincentives

Treasury continued to take the leading role within the Government in guiding U.S. efforts to encourage international consideration of the problems associated with governments' use of investment incentives and disincentives and possible ways of dealing with them.[9] The OECD's member governments, on completing a review of their 1976 Investment Declaration, adopted a U.S. suggestion that they undertake a study of such measures. The study will examine (1) the impact of investment incentives and disincentives on international direct investment flows and (2) the international effects of competition among governments in the use of incentives to attract direct investments. A report will be produced early in 1981 which will serve as a basis for determining what further work is to be done, including work to improve international cooperation in this area.

The incentives issue was also the subject of further discussions between the Governments of the United States and Canada. These discussions stemmed from U.S. protests about a grant given by Canada to the Ford Motor Co. to induce it to locate a new plant in the Province of Ontario. The ongoing discussions are aimed at agreement on cooperation in curbing the use of incentives in the auto sector by governments on both sides of the border.

The Task Force on Private Foreign Investment, a subgroup of the Joint Development Committee of the International Monetary Fund (IMF) and World Bank (IBRD), was established and began meeting in fiscal 1979 under the chairmanship of Treasury Assistant Secretary Bergsten. This group consists of delegates at the subministerial level from 12 major industrial and

[9] See exhibit 51.

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developing nations who meet periodically to discuss investment-related problems of mutual concern. The group is focusing on conflicts of policy among home and host nations, including those resulting from investment incentives and performance requirements (measures used by governments to assure that investors contribute to their policy objectives). The task force will submit its policy recommendations to the full Development Committee, which consists of the Secretary of the Treasury and Ministerial representatives of other IMF and IBRD member countries, late in fiscal 1980.

During the fiscal year, the Committee on Foreign Investment in the United States (CFIUS) met to coordinate U.S. policy on and to monitor current trends and developments in inward investment.[10] Among the specific issues it took up were the status of new surveys on inward investment being undertaken by the Departments of Commerce and the Treasury under the International Investment Survey Act of 1976; the Agriculture Department's efforts to monitor foreign purchases of U.S. farmland; and the investment by the French automobile manufacturer Renault in American Motors Corp.

Assistant Secretary Bergsten, who chairs the CFIUS, testified in July 1979 before a congressional subcommittee on the CFIUS' operations. His statement contained a comprehensive survey of the principles on which it functions and what it had done since it was established.[11]

United States-Saudi Arabian Joint Commission on Economic Cooperation

In November 1978, Secretary Blumenthal led the American delegation to the fourth annual meeting of the Joint Commission held in Jidda, Saudi Arabia.[12] At the meeting, the two Governments signed three new project agreements in the areas of executive development training, transportation, and agriculture credit banking. The signing of these project agreements brought the total number of major projects to 19.

Construction is well underway in a number of the projects. A Kingdom-wide network of vocational training facilities is under construction; a large, modern financial information center will be completed in 1980; and construction is about to begin on the world's largest solar-powered electrical generating station.

There are presently over 160 American specialists working in Saudi Arabia under Joint Commission auspices.

Commodities and Natural Resources Policy

International commodity developments

During fiscal 1979, developments in U.S. commodity policy included virtual completion of successful negotiation of the Natural Rubber Agreement, substantial progress in the negotiation of the common fund, and an increase in the allowable U.S. grain sales to the Soviet Union under the 5-year

[10] See exhibit 53.
[11] See exhibit 77.
[12] See exhibit 44.

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U.S.-U.S.S.R. grain agreement. [For urgent reasons of national security and foreign policy, the President in early 1980 rescinded the decision on allowable grain sales to the Soviet Union, directing them to be held to the level of 8 million tons authorized under the grain agreement with the U.S.S.R.]

The Integrated Program for Commodities (IPC).—The IPC was agreed to at the United Nations Conference on Trade and Development (UNCTAD) IV in 1976 and was reaffirmed at UNCTAD V in Manila in June 1979. That document is the framework for the ongoing international commodity discussions and provides for a work program consisting of discussions concerning commodity problems, negotiations of agreements where feasible and desirable, and establishment of a common fund to facilitate financing of commodity agreements and development projects.

A major objective of the IPC is greater efficiency and stability in world commodity markets, an objective the United States steadfastly supports.[13] A successful commodity program focused on this goal would provide benefits to both producers and consumers by reducing price fluctuations and promoting adequate future supplies at fair prices.

As the IPC has unfolded, the United States has played an active and constructive role in commodity discussions. In the U.S. view, market efficiency and stability are best achieved through commodity agreements involving buffer stocks. It is recognized, however, that some commodity problems cannot be resolved by market intervention mechanisms and will require "other measures" aimed at improving production and distribution efficiency, expanding markets for particular commodities, and upgrading the flow of market information.

UNCTAD V.—At the May-June meeting of UNCTAD V, developed and developing countries welcomed the March agreement to the framework text on the common fund and urged conclusion of negotiations by the end of the year. Developing countries also expressed regret over the slow pace of discussions and negotiations for individual commodities and pressed for an accelerated schedule to complete negotiations of new agreements. Also, they urged revision of price ranges in existing agreements to reflect changes in prices of manufactured goods, exchange rates, production costs, world inflation, and the interests of developing countries. The United States opposed incorporation of these factors in setting price ranges because they could lead to prices which could upset the long-term equilibrium which in turn could cause inefficient allocation of resources.

The developing countries also pushed hard for a framework for international action on "other measures" in commodities. Although many of the objectionable details in their proposal were deleted, the "framework" remained and the future UNCTAD commodities work will probably be expanded into commodity processing, product and market development, and marketing and distribution activities.

[13] See exhibit 54.

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The most contentious issue was the developing country insistence on a "complementary facility" to finance shortfalls in their commodity export earnings. The resolution was passed by a majority of the Conference, but most of the developed countries opposed it on the grounds that it would duplicate the compensatory financing facility of the IMF and would be an inappropriate mechanism for providing development assistance.

Finally, all countries urged that negotiation of a new International Wheat Agreement incorporating a system of reserve stocks be completed as soon as possible.

Common fund.—The common fund will have two major functions—facilitating the financing of commodity stocking operations and financing of selected commodity development projects. The "first window" will pool the cash resources of international commodity agreements (ICA's), borrow from commercial markets, and make loans to ICA's to finance stocks. The "second window" will make loans and grants to agreements and/or countries to finance research and development, market promotion, vertical diversification, or other commodity projects.

A major breakthrough in the negotiation of the common fund was achieved during the third session of the negotiating conference held in March 1979. At this session, agreement was reached on most of the major elements of the common fund, though the United States expressed dissatisfaction over several items, most notably the voting distribution. This and other outstanding issues will be resolved during the course of a series of Interim Committee meetings set up to produce the Articles of Agreement. The target date is early 1980. The first session of the Interim Committee was held in September 1979 and began intensive review of the draft Articles of Agreement which had been prepared by the UNCTAD Secretariat.

Commodity developments

Rubber.—After 18 months of negotiations, Articles of Agreement for a Natural Rubber Commodity Agreement were finally completed in early October 1979. This is the first new agreement under the IPC, and it is scheduled to enter into force October 1, 1980. The agreement includes a 550,000-metric-ton buffer stock as the only price stabilization instrument; financing commitments for the full amount from member governments; a wide price range around a reference price subject to revision based on market prices and buffer stock activity; and price boundaries to limit a revision in the price range. The agreement also bases a member country's votes on trade shares and all votes are to be paid for at least in part, thus fostering an agreement composed of exporters and importers with a substantial interest in natural rubber. The agreement is now subject to congressional ratification.

Copper.—UNCTAD discussions on copper began in late 1976 and have yet to advance, in spite of frequent meetings, beyond the preparatory stage. Participating countries have expressed widely differing points of view: Some countries (such as Chile, Canada, and West Germany) seek only a producer-

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consumer forum for periodic consultations on the copper market. Others (such as Peru, Norway, and France) have argued for a price stabilization agreement based on a small buffer stock supplemented by export and/or production controls. In February, the United States attempted to sharpen discussions by suggesting a large buffer stock (at least 1 million metric tons) as the only means of stabilizing the market. Although other countries have been unwilling to support this scheme, the United States has continued to insist that it be fully discussed. Because of the wide range of country views on alternative mechanisms, discussions in September again reached no conclusions and talks were scheduled to resume in early 1980.

Cocoa.—The two sessions of the negotiating conference held in February and July 1979 failed to complete a new agreement. The United States refused to join the expiring 1975 agreement because of its reliance on a rigid system of export quotas and the narrow price range. But the current renegotiating conference has accepted the key U.S. proposal of an international buffer stock as the sole market intervention mechanism, at least until it reaches 250,000 metric tons. The stock could be expanded to 350,000 tons. The July session of the conference adjourned primarily because of a lack of agreement on the price floor with producers seeking something above $1.10 per pound. The United States, however, continued to be concerned about inadequate financing. In the current draft, financing relies on a levy-based fund which will not reach full strength for several years, supplemented by commercial loans.

Coffee.—The United States is a member of the International Coffee Agreement (ICA), and in 1979 signified its intention to continue as a member for 3 more years. The administration requested legislation to permit it to fulfill U.S. obligations when, and if, the economic provisions go into effect. Congress had not yet completed action by the end of the fiscal year. The economic provisions of the 1976 agreement have not been in effect because coffee prices have been above the price range. In September 1979, producers and consumers met to discuss raising the trigger price from $0.78 to $1.34 a pound, but no agreement was reached. Meanwhile, Latin American coffee producers, citing an "ineffective ICA," have been operating to bolster coffee prices through a producers' organization called the Bogota Group (BG). Consumers have complained publicly. Producers maintain the BG is necessary to protect their interest until the ICA price range is revised and its economic provisions allowed to operate under conditions which would offer some protection against sharp declines from currently high prices.

Sugar.—The International Sugar Agreement (ISA) was negotiated in September 1977, and was ratified by Congress in December 1979. Most countries believe that informal adherence to the quota and stocking provisions of the provisional ISA have been instrumental in raising sugar prices from an average of 7.59 cents per pound in 1977–78 to 9.90 cents at the end of fiscal 1979.

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Wheat.—After years of attempting to renegotiate the International Wheat Agreement (IWA) to incorporate economic provisions, negotiations were suspended in February 1979, pending bilateral consultations to seek a basis for reconvening them. The Wheat Council, the IWA governing body, is expected to decide early in fiscal 1980 on the feasibility of reopening the talks.

Grains sales to the Soviet Union.—During the third year of the grain agreement between the United States and the Soviet Union, exporters sold 15.7 million metric tons of U.S. grain to the U.S.S.R. consisting of 4 million tons of wheat and 11.7 million tons of corn. Because of prospects for a poor 1979 harvest in the Soviet Union and adequate supplies in the United States, the Soviets were authorized to purchase up to 25 million tons of U.S. grains in the fourth year of the agreement, beginning October 1, 1979. [In early 1980, in response to the Soviet Union's invasion of Afghanistan, the President, under the authority of the Export Administration Act of 1979, suspended grain shipments to the U.S.S.R. in excess of the 8 million tons per year required under the terms of the 5-year agreement between the two countries.] According to the agreement, at least 3 million tons each of wheat and corn must be purchased.

World oil market

Tight world oil supplies accompanied by sharp oil price increases characterized the energy situation during fiscal 1979.[14] The disruption of production in early 1979, associated with the Iranian revolution, resulted in a temporary world oil supply shortfall and triggered a chain of events which substantially transformed the world oil market. Even with resumption of more normal levels of production in Iran and increased production by Saudi Arabia and some other producers, the oil market situation remained tight as consumers rebuilt stocks depleted in early 1979 and in the face of continuing supply uncertainties.

In addition, oil producers began to sell large quantities of oil either at spot market prices or under government-to-government deals, thus increasing their control over prices and supply. Collectively, these changes have resulted in increased uncertainty of supply and have decreased the capability of the world oil market to respond to emergencies, thus increasing the vulnerability of the United States to future supply disruptions.

Increased uncertainty of supply has been accompanied by rapidly escalating prices. From December 1978 to November 1979, the average official price of Organization of Petroleum Exporting Countries' (OPEC) oil exports increased by about 65 percent—from about $12.93/bbl to $21.40/bbl. Non-OPEC producers increased prices even more than OPEC—from $13.79/bbl to an average of over $24/bbl. In addition, spot market prices for crude oil surged from 1978 levels of about $12.50/bbl to $36/bbl in June 1979 and over $40/bbl in October 1979. When spot priced crude oil (estimated at 10 percent

[14] See exhibits 55 and 77.

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of volume) is taken into account, the average price for crude oil increased by about 80 percent from December 1978 to November 1979.

These OPEC price increases were a major factor depressing economic progress and intensifying inflationary pressures in the United States and are expected to result in at least a 1-percent decrease in real GNP growth and a 1-percent increase in inflation in both 1979 and 1980. For the OECD as a whole, the impact of the price increases is expected to be even more severe.

More generally, the oil price increases are expected to reverse much of the progress that has been made in improving the world balance of payments as the OPEC surplus increases and the OECD countries as a group move from surplus to deficit. The position of the nonoil developing countries is also expected to deteriorate sharply.

Energy policy

The administration has given high priority to the development of a national energy program aimed at reducing our dependence on foreign imported oil. In July 1979, the President announced major actions designed to reduce oil imports, including the creation of an Energy Security Corporation to direct the development of synthetic fuels and the setting of oil import quotas at levels below those agreed to at the Tokyo economic summit (see next section). Other elements of the administration's policy include the gradual decontrol of domestic crude oil prices and the proposed windfall profits tax on domestic crude oil production, the revenues from which will be used in part to finance the development of synthetic fuels. Treasury's interest in these policies centers on their fiscal, financial, and economic implications.

During the year, Treasury staff participated in the evaluation of issues affecting domestic and international energy policy. Among these, Treasury gave particular attention to the effects of OPEC price and supply decisions on the U.S. economy, demand restraint and oil import quotas in the context of our International Energy Agency (IEA) and Tokyo economic summit commitments, and energy exploration and development in developing countries. In addition, Treasury participated in an interagency group to reappraise U.S. oil stockpiling policy. Treasury officials engaged in international and bilateral discussions on energy and responded to numerous invitations by Congress and the public to speak on a wide range of energy issues.

Tokyo economic summit[15]

At the June 1979 Tokyo economic summit, the leaders of seven industrialized countries, recognizing the seriousness of the world energy problem, agreed on important measures aimed at decreasing dependence on foreign imported oil. The major commitment taken at the summit was the establishment of individual country import targets and a high-level group to monitor

[15] See exhibit 68.

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the targets. The participants each committed themselves to limits on oil imports in 1979 and 1980, limits to be applied on a country-by-country basis. The limit set for the United States was 8.5 mmb/d in both years—equivalent to our imports of 1977. For the medium term, the summit countries adopted specific goals for oil imports in 1985. Other major commitments included agreement to establish a register of international oil transactions and an International Energy Technology Group to encourage the development of alternative fuel sources.

Substantial progress was made in implementing the Tokyo summit commitments as a result of decisions taken at the September 1979 Summit Energy Ministerial.

International Energy Agency (IEA)

The IEA continues to serve as an important vehicle for the coordination of the international energy policies of 20 industrialized oil-consuming member countries. IEA efforts have been directed at reducing dependence upon imported oil through conservation, accelerating development of indigenous resources, and furthering research and development. In addition, the IEA has developed methods to restrain demand and share existing supplies in the case of a supply emergency situation. The importance of IEA activities and the need for policy coordination was emphasized by developments in the world oil market in early 1979—in particular, the world oil supply shortfall. Treasury participated in the meetings of the Governing Board and several subordinate groups.

Standing Group on Emergency Questions (SEQ).—The SEQ maintained a close watch on the oil import positions of member countries during the tight supply situation which followed the disruption of Iranian production. In May 1979, Sweden, experiencing a fall in its oil import level, requested that the emergency oil supply sharing mechanism be triggered. While the IEA decided against the claim, Sweden's import position shortly did improve. The Group also worked on establishing a Dispute Settlement Center, which would serve as a forum for settling price disputes arising during implementation of the emergency oil supply sharing mechanism.

Standing Group on Oil Markets (SOM).—The SOM was involved in tracking development of the Iranian shortfall and carried out joint studies with the SEQ on the near-term oil market outlook and the level of stocks and import shortfalls in IEA countries. The Group worked to establish an international register of oil transactions as decided upon at the Tokyo economic summit. A registration system for crude oil was adopted as of November 1, 1979, while work on developing a register for products continues.

Standing Group on Long-Term Cooperation (SLT).—The SLT developed an international program to increase the trade, use, and production of steam coal adopted by IEA members at the May 1979 Ministerial meeting and which served as the basis for the Tokyo summit statements on coal. In addition, the

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Group was concerned with developing individual country oil import targets for 1980 and 1985 as well as revised group targets for 1985 and 1990. The SLT also publishes an annual assessment of the energy programs of IEA member countries.

LDC energy development

In its relations with the developing countries, the United States has been guided by the belief that reducing the dependence of developing countries on expensive oil imports would both further their development and improve the world energy balance. As a result, the United States took further steps to assist these countries in developing their own energy resources.

In particular, the U.S. Government supported the January expansion of the World Bank lending program to cover petroleum exploration as well as production projects. Under this program, it is envisioned that the Bank's annual lending for oil and gas projects would expand to about $1.5 billion by 1983.

At the Tokyo summit, participants once more agreed to "strongly support the World Bank's program for hydrocarbon exploitation and urge its expansion." The Bank was also asked to consider coordination of bilateral efforts at assisting the developing countries in renewable energy. The World Bank prepared a study on renewable energy sources in less developed countries.

In addition to the above efforts, the Agency for International Development and the Department of State have programs to assist less developed countries to develop renewable energy technologies. An Overseas Private Investment Corporation (OPIC) program provided insurance coverage for two new energy investment projects in Egypt and Ghana.

Oceans policy

Treasury continued to play an important role in two major areas of oceans policy in 1979: The economic provisions in ocean mining legislation and the seabed mining negotiations within the U.N. Law of the Sea Conference. The legislation was reintroduced in the new Congress, after narrowly missing passage in the 95th Congress. Progress was made in specific areas at the Law of the Sea Conference, most notably on financial issues, but wide gaps still separate the United States from other countries on a number of issues.

Ocean mining legislation.[16] —The primary objective of the new legislation is to establish a Federal administrative structure which would provide a domestic legal framework under which prospective ocean mining firms can expect to operate as they make their investment and development decisions. The administration designated the National Oceanic and Atmospheric Administration (NOAA) at Commerce as the administering agency for the new program when it is enacted. At the end of the fiscal year, the legislation

[16] See exhibit 56.

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had cleared most of the legislative milestones, and prospects for final action seemed promising.

Law of the Sea Conference.—The third U.N. Conference on the Law of the Sea completed its eighth session in New York without reaching agreement on a final composite treaty text, but with growing resolve to substantially complete negotiations in 1980. Although past sessions have achieved agreement on navigational and jurisdictional issues, major disagreements continue in the seabed mining negotiations. Discussions and redrafting of texts were undertaken on a number of issues.

Treasury has taken particular interest in the system of financial payments which private and national entities mining the seabeds must make to the International Seabed Authority (which collects the payments on behalf of the international community). During the eighth session, substantial progress was made in developing a system of payments which would maximize revenue to the Authority without significantly deterring investment in seabed mining. The structure of the new text represents a carefully balanced financial package which attempts to meet the concern of potential seabed mining countries and the developing countries.

Unresolved key issues are: (1) Provision for a decisionmaking system which will assure nondiscriminatory access to the seabeds for technically qualified miners, (2) assurance that obligations for technology transfer be on fair and reasonable commercial terms and limited to the initial projects of the Enterprise, (3) terms and conditions of access for exploration and production which will not deter investment, and (4) avoidance of production controls or moratorium provisions which significantly restrict mining.

International Monetary Affairs

World economic and financial developments

The world economy.—Once again, oil market developments dominated the world economy during fiscal 1979. Starting last fall with the political crisis in Iran, and the related oil production curtailment, oil prices rose sharply and oil markets became increasingly unstable. Supply uncertainties and a 60-percent rise in official oil prices during the fiscal year adversely affected oil-importing countries worldwide.

Because U.S. growth slowed in 1979, the growth shown by developed nations as a group slowed by almost 1 percent during calendar 1979 to an average OECD growth rate of 3 percent. The prospects are for a further slowing of growth as the U.S. restraint policies take effect and the effects of sharply higher oil prices have their full impact.

The U.S. economic slowdown is also causing an important shift in the real growth patterns among the major industrial nations. The United States and the group of six other largest industrial countries (Japan, Canada, United Kingdom, France, Germany, and Italy) grew at about the same rate—3.9 percent—in calendar 1978. In calendar 1979, however, U.S. real growth

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slowed to around 2 percent while the "Big-Six" continued to maintain growth of about 3.9 percent.

Inflation—aggravated by oil price hikes and rising prices for other commodities—became an even more serious global problem. In the industrial countries, the progress made in reducing price increases in 1978 was reversed in 1979. By midyear, prices were rising at a 13-percent annual rate although for the year as a whole price increases were expected to average only about 8 percent. In 1979 American cost-of-living increases were somewhat higher than the average inflation rates in the other OECD countries. While growth in the LDC's has remained near the 5-percent level for the third straight year, virtually no progress has been achieved in bringing inflation below the 30-percent level of recent years. The prospects are for further deterioration in global inflation rates in 1980.

Concerns about energy and inflation were the main preoccupation of economic policymakers during fiscal 1979. The Bonn economic summit of July 1978 had identified unemployment as the primary economic problem facing the developed nations of the world. But the Tokyo economic summit,[17] held in June 1979, in the wake of a sharp oil price increase in the first 6 months of 1979, was largely concerned with questions of energy and inflation.

The international balance of payments situation.—The world balance of payments situation has been dramatically altered by the oil price increase during calendar 1979. The OPEC current account surplus, which had remained in the $30–$37 billion range (including official transfers) for 1975–77, fell sharply to near balance in 1978. This drop in the OPEC surplus was accompanied by an almost equal movement of the OECD current account from a $26 billion deficit in 1977 (including official transfers) to a surplus of $9 billion in 1978. The nonoil LDC's, however, partly owing to strong domestic growth, continued to run substantial current account deficits in 1978. Taken together, all non-OPEC LDC's ran a deficit of $22 billion in 1978, which was about the same annual deficit they ran in the years 1974–77.

The oil price hikes of 1979, however, have substantially changed the world payments picture. The OPEC current account surplus is expected to rise from rough balance in 1978 to some $60 billion in 1979. The bulk of this rise is being absorbed by the OECD countries whose current account position is expected to deteriorate by nearly $40 billion to a deficit of $30 billion in 1979. The aggregate current account deficit of the non-OPEC LDC's will rise about $10 billion to more than $30 billion in 1979.

Although the rise in oil prices is causing problems for a number of countries, most nations seriously affected by higher oil import costs appear able to finance their oil purchases. Most of the increase in the non-OPEC LDC current account deficit in 1979 was concentrated in a few countries with relatively strong positions and access to private capital markets.

[17] See exhibit 68.

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Major shifts also occurred in the pattern of current account balances among developed countries in 1979. The U.S. current account was in approximate balance in 1979, compared with a deficit of $13.4 billion in 1978. Japan and Germany are both experiencing major adjustment of their current account surpluses. The Japanese current account is shifting from a surplus of $16.5 billion in 1978 to a sizable deficit in 1979. The German current account surplus has also shifted into deficit in 1979 after a sizable surplus in 1978.

International bank lending and the Eurocurrency market.—The private markets continued to provide the bulk of the funds for meeting balance of payments financing needs. Despite the reduction in net new financing needs in 1978, the private banking system's intermediation of international credit flows rose at a slightly faster pace than previous years. New private lending, net of repayments and excluding purely interbank activity, amounted to approximately $100 billion. The pace slowed early in 1979 but then regained most of its earlier momentum as financing needs increased following the June 1979 oil price increases.

Several factors account for the continuing demand for international credit in 1978. There were substantial increases in GNP, measured in nominal terms, with trade flows growing even more rapidly. Also, a number of countries borrowed in order to increase their foreign exchange holdings. On the supply side, a high degree of liquidity in OECD countries, particularly certain European countries, encouraged substantial flows of funds into international lending which more than offset the temporary drying-up of oil-exporting countries as a major source of funds.

U.S. authorities did not consider the magnitude or growth rate of international lending to be excessive to the needs of the global economic system but shared the views of many observers that a careful review of a number of questions relating to international banking activity, particularly the implication of Eurocurrency banking for management of domestic monetary policy, was appropriate. Accordingly, the Federal Reserve System, with the support of the Treasury, helped to initiate a study of these questions by the central banks of the major countries.[18]

Oversight of the international activities of individual U.S. banks is generally considered to be the most sophisticated and comprehensive in the international financial system. During the fiscal year, the U.S. regulatory regime was further strengthened by implementation of a new system for identifying any concentration of lending to countries with large debt burdens and the publication by the Comptroller of the Currency of a final interpretive ruling on the application of the legal lending limit stipulated in 12 U.S.C. 84 on loans to foreign governments and their instrumentalities.

Treatment accorded to U.S. banks by foreign governments[19]. —Section 9 of the International Banking Act of 1978 directed the Secretary of the Treasury, in conjunction with the Secretary of State, the Federal Reserve Board, the

[18] See exhibit 77 (Solomon, July 12, 1979).
[19] See exhibit 77 (Carswell, July 16, 1979).

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Comptroller of the Currency, and the Federal Deposit Insurance Corporation, to undertake a "study of the extent to which banks organized under the laws of the United States or any state thereof are denied, whether by law or practice, national treatment in conducting banking operations in foreign countries, and the effects, if any, of such discrimination on United States exports to those countries." The Secretary transmitted in September 1979 his "Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations."

Based on a detailed investigation, including information from bank surveys and from U.S. diplomatic posts worldwide, the report concluded that, in the great majority of foreign countries, U.S. banks are able to function without significant interference or discrimination. The study found no evidence of any less favorable treatment of U.S. banks than of other nonindigenous banks. Nor was there any evidence that U.S. exports were significantly impeded by discriminatory treatment of U.S. banks abroad.

Foreign exchange market developments and operations.—In fiscal 1979, the dollar appreciated slightly on a trade-weighted basis against other OECD currencies and appreciated markedly against the currencies of countries which account for about 90 percent of U.S. total trade. In terms of certain major foreign currencies, however, the dollar moved more sharply, depreciating 10 percent against the German mark and British sterling, while appreciating 18 percent against the Japanese yen.

U.S. and foreign monetary authorities intensified their efforts to curb unwarranted exchange rate movements, in response to highly volatile conditions in the foreign exchange markets which developed in particular during the fall and winter of calendar 1978. Anti-inflationary policies in the United States and coordinated intervention operations were employed to restore a sense of two-way risk in exchange markets, which had increasingly overreacted to short-term factors in disregard of fundamental economic trends. The Treasury assumed a major responsibility, with the Federal Reserve, for the conduct of foreign exchange market operations, and undertook the mobilization of large resources for financing these operations. Although the markets experienced further periods of intense activity and pressure during the year, these operations were successful in maintaining lengthy periods of relatively calm, balanced trading. That more progress was not achieved basically reflected the lack of improvement which had been expected in reducing U.S. inflation and the adverse developments in the global availability and price of oil.

At the onset of the fiscal year, the foreign exchange market was experiencing severe and persistant disturbances which led to an excessive decline of the dollar that hampered U.S. efforts to bring inflation under control and undermined the financial stability of the system. Consequently, on November 1, 1978, the Treasury and Federal Reserve announced a package

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of measures[20] to strengthen the dollar at home and abroad by intensifying U.S. anti-inflationary efforts, reducing the balance of payments deficit, and dealing directly with the exchange market disorders. The package included an increase in the Federal Reserve discount rate from 8.5 to 9.5 percent, implementation of a supplemental 2-percent reserve requirement on time deposits of $100,000 or more, and an increase in the Treasury's monthly gold auction to 1.5 million ounces from 750,000 ounces. In addition, a total of up to $30 billion foreign currency resources was mobilized for use by the United States in financing its share of exchange market intervention undertaken in cooperation with other major countries. These resources included an increase in the Federal Reserve's swap arrangements with the central banks of Germany, Switzerland, and Japan from $7.6 billion to $15 billion, the sale by the Treasury of up to $2 billion equivalent of special drawing rights (SDR's) for foreign currencies, U.S. drawings of foreign currencies of up to $3 billion equivalent from the IMF, and the issuance by the Treasury of up to $10 billion of foreign-currency-denominated securities.

Despite these actions, however, market psychology remained quite negative, and the dollar continued to experience periodic selling pressure during the greater part of November and December. Disappointing U.S. trade and price data, the lack of progress on energy legislation, political turmoil in Iran, and the decision by OPEC in December to raise oil prices by 15 percent were factors inducing dollar selling, albeit at exchange rates higher than prior to the November 1 announcement.[21] The central banks of Japan, Switzerland, and Germany joined the Federal Reserve and Treasury in forceful intervention in these 2 months, during which the U.S authorities made net sales of $5.9 billion equivalent of German marks, Swiss francs, and Japanese yen.

By late December, market psychology had begun to turn in favor of the dollar. Trading conditions became more balanced. The OPEC oil price increase stimulated a demand for dollars. The publicity attached to the U.S. issuance of Treasury securities in Germany in December and Switzerland in January, which augmented U.S. foreign currency resources by $1.6 billion equivalent of German marks and $1.2 billion equivalent of Swiss francs, underscored the strong U.S. commitment to support the dollar from speculative attacks, improving the balance of payments position and reducing inflation. With more orderly conditions in the market and confidence in U.S. policies enhanced, capital flows responded to fundamental economic factors. U.S. interest rates, higher than those in most other major countries, induced a flow of funds into dollar assets, and encouraged a reversal of commercial leads and lags. There ensued a period, lasting through mid-June 1979, during which the dollar was generally in demand.[22]

Monetary authorities remained active during this phase of dollar strength. In early January, Federal Reserve commitments under swap lines with the

[20] See exhibits 57, 58, and 59.
[21] See exhibit 60.
[22] See exhibit 64.

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German Bundesbank, the Swiss National Bank, and the Bank of Japan rose to a peak of $5.5 billion. U.S. Treasury drawings on its Bundesbank swap facility totaled $0.9 billion, and the Treasury had utilized $1.8 billion of the currencies obtained through IMF and SDR transactions and from the issuance of foreign currency securities. By the end of May, however, all Treasury and Federal Reserve swap commitments had been repaid and, combined, the Treasury and Federal Reserve had become net purchasers of foreign currencies since the November announcement. In addition, the Treasury and Federal Reserve repaid, ahead of schedule, the remaining pre-August 1971 debts in Swiss francs held by the Swiss National Bank.

In total, during the 5 months ending May 31, 1979, U.S. authorities made net market and nonmarket purchases of almost $8 billion equivalent of German marks, Swiss francs, and Japanese yen. In addition, on March 1 the Treasury issued a second tranche of DM-denominated securities in Germany, receiving $1.35 billion equivalent of German marks from the sale of 2½- and 3½-year securities. The Swiss, Japanese, and German authorities also sold dollar reserves during the period in order to absorb domestic liquidity generated by past intervention operations.

During the summer, however, conditions in the foreign exchange market began to deteriorate and sentiment again turned bearish on the dollar. Although the U.S. balance of payments continued to improve, a further rise in inflation and new oil price increases cast doubts about U.S. ability to achieve a satisfactory position. U.S. interest rates had tended to ease, while growth in monetary aggregates had surged. Temporary factors which had contributed to earlier dollar demand, principally the reversal of short dollar positions and commercial leads and lags, had ended while the market perceived that the large dollar sales by monetary authorities would limit the risks of further dollar appreciation. Finally, a movement in interest differentials against dollar assets and strains in the European Monetary System (EMS) caused new flows into foreign currencies, particularly the German mark.

In response to the inflation and exchange market situation, the Federal Reserve tightened monetary conditions further. The discount rate was raised by one-half percent in July to 10 percent and then to a record 11 percent in two ½ percent increments during August and September. Intervention in the foreign exchange market also increased considerably. In the period June–September the Treasury and Federal Reserve sold $7.8 billion of German marks and Swiss francs.

During the fiscal year, the Treasury issued a total of $4,150 million equivalent of foreign-currency-denominated securities in the German and Swiss markets. At the end of the period, the net exchange translation liability of the general account of the Treasury associated with the issuance of these securities totaled $237 million.

[On October 6, the Federal Reserve announced forceful new measures to bring inflation under control and slow the growth of the money supply. The

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Federal Reserve altered its management of the monetary aggregates by placing greater emphasis on controlling the supply of bank reserves and less on short-term fluctuations in the Federal funds rate. In addition, the discount rate was raised a further 1 percent to the 12-percent level and an 8-percent marginal reserve requirement was placed on increases in "managed liabilities." The dollar appreciated sharply against all major foreign currencies following this announcement and market conditions improved markedly.]

Gold market developments

Gold prices continued to rise throughout most of the fiscal year in uneven and volatile markets, responding in particular to further large increases in oil prices, increased worldwide inflation, and unsettled political conditions in the Middle East. Prices moved from about $217 per fine troy ounce at the beginning of the fiscal year to a low of $193 in November, and reached a high of $397 at the close of the year amid increasing speculative pressures.

The Treasury continued its sales of gold at monthly public auctions through the fiscal year. The amounts offered were increased from 300,000 ounces in October 1978 to 1.5 million ounces in December 1978 in connection with the program to strengthen the dollar in the foreign exchange markets. In May 1979 the monthly amounts were reduced to 750,000 ounces in light of the fact that gold no longer appeared to be a destabilizing factor in the foreign exchange markets. [After the close of the fiscal year, on October 16, 1979, the Treasury announced a more flexible approach to the conduct of the gold sales, in order to help deter the disruptive speculation that had again characterized the gold market. Accordingly, future sales of gold would be subject to variations in amount and date of offering. On October 25, the Treasury announced that it would offer up to 1.25 million ounces on November 1.]

Public sales of gold by the Treasury contribute to several important U.S. objectives: They help reduce the U.S. trade deficit; they respond directly to conditions in the gold market, which may contribute to an adverse psychological atmosphere in the foreign exchange markets; and they promote the internationally agreed effort to reduce gradually the monetary role of gold.[23]

In fiscal 1979 the Treasury gold sales program improved the U.S. trade position by approximately $3.1 billion, by reducing gold imports and increasing gold exports. Profits from the gold sales, applied to financing the fiscal 1979 Federal budget deficit, totaled $2.4 billion.

Pursuant to the American Arts Gold Medallion Act of 1978 (Public Law 95–630, November 10, 1978),[24] the Treasury prepared to produce and sell to the public 1-ounce and one-half-ounce gold medallions. The act authorizes the sale of medallions containing at least 1 million ounces of gold annually

[23] See exhibit 62.
[24] See exhibit 24.

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over a 5-year period. The medallions are scheduled to be placed on sale in the late spring of calendar 1980.

International monetary arrangements

The International Monetary Fund is the central monetary institution for the world economy and the principal source of official balance of payments financing for its members. The IMF serves as the financial backstop for the system, as a lender of last resort for countries experiencing balance of payments difficulties and as a source of encouragement for countries to pursue timely and effective measures to correct these problems. In addition, the Fund is responsible for overseeing the management and adaptation of the system over the longer term.

During the fiscal year, the IMF responded to changing payments patterns and problems by expanding and modifying its financial policies to meet the evolving needs of its members. Moreover, the Fund has initiated several important steps to guide the future evolution of the system.

Meeting official financing needs

In the past few years the amount of financing provided by the IMF has declined steadily due to successful stabilization efforts and the availability of alternative sources of financing. Recent oil market developments have radically altered the economic outlook and caused the reemergence of large payments imbalances. While the private markets are expected to provide the bulk of the global financing required, it must be anticipated that some individual countries will encounter difficulties and require official financing. The IMF took a number of actions during the year to strengthen its ability to meet official financing needs that may arise.

IMF quotas.—The basic resources of the IMF are derived from the quota subscriptions of members. On December 11, 1978, the IMF Board of Governors concluded the seventh general review of quotas by adopting a resolution proposing a 50-percent increase in quotas, from SDR 39 billion (about $50 billion) to SDR 58.6 billion (roughly $75 billion). The quotas of most members will be increased by a uniform proportionate amount, 50 percent, although a very few countries will receive selective increases, on the basis of relative increases in their position in the world economy. The resolution provides that members which participate in the Special Drawing Rights Department will pay 25 percent of the quota increase in SDR's and other members will pay the equivalent of 25 percent of their quota increases in the currencies of other members specified by the Fund. Thus all members will provide at least 25 percent of their quota increase in reserve assets. The remaining 75 percent of the quota subscription will be paid in the members' own currency.

The expanded quotas will become effective by November 1, 1980, provided members having 75 percent of total quotas on November 1, 1978, consent to the increase in their quotas. The resolution proposes an increase in the U.S.

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quota of SDR 4,202.5 million, from SDR 8,405 million to SDR 12,607.5 million. Congress must approve any increase in the U.S. quota, and the required legislation was submitted during the early part of fiscal 1980.

Supplementary Financing Facility.—This facility, described in detail in the 1977 Annual Report, began operation on February 23, 1979. The facility is a temporary supplement to regular IMF operations, financed with funds borrowed from a number of industrial and oil-exporting countries, to provide expanded financing, in conjunction with the use of regular IMF resources, to countries experiencing severe balance of payments difficulties. In effect, the facility is intended to provide a bridge until the quota increase expands the IMF's resources on a permanent basis. The total resources of the facility amount to SDR 7,784 million (about $10.1 billion), of which the United States agreed to provide up to SDR 1,450 million (but not to exceed the roughly $1.8 billion appropriated). At the end of the fiscal year only a small portion of these resources had been drawn, leaving a substantial amount available for members facing financing difficulties over the next 2 years.

Compensatory financing facility.—The facility was established in 1963 to provide additional access to IMF resources for countries experiencing payments difficulties due to temporary shortfalls in export earnings arising largely from factors beyond their control. In August 1979, the IMF decided on a major liberalization of the facility, raising the amount a member may draw in a 12-month period from 50 to 100 percent of quota and increasing the maximum level of outstanding drawings from 75 to 100 percent of quota. In addition, the coverage of the facility was broadened by permitting the inclusion of receipts from travel and workers' remittances, and the method of calculating shortfalls was modified to provide a more even distribution of financing. The decision also provides that a member which draws in excess of 50 percent of quota from the facility must satisfy the IMF that it is cooperating with the Fund to find appropriate solutions for its balance of payments difficulties. These modifications of the facility should be especially useful at a time when slower growth in the world economy could cause increased export shortfalls.

IMF conditionality.—During the fiscal year, the IMF completed a review of policies and conditions on the use of Fund resources by adopting new guidelines on the application of IMF conditionality. IMF conditionality consists, in the broadest sense, of the requirement that a member using Fund resources implement a program to correct its balance of payments problem and provide assurance of repayment to the IMF within a short- to medium-term period. The effective application of conditionality is essential to the IMF's efforts to promote an open world economy and a stable, smoothly functioning international monetary system.

The revised guidelines reflect the changes which have taken place in the world economy and international monetary system during the 1970's. The main revisions in the guidelines are to:

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- Encourage countries to come to the Fund at an earlier stage in their difficulties;
- Stress uniform application of conditionality to all members;
- Provide for standbys extending beyond 1 year in appropriate cases;
- Minimize IMF involvement in microeconomic choices and focus IMF conditions on broad macroeconomic aggregates;
- Make clear that in helping a member devise an economic program the Fund will pay due regard to the member's economic circumstances and domestic political and social objectives; and
- Establish a systematic procedure for reviewing the effectiveness of IMF programs.

Evolution of the system

The economic problems of the past decade have demonstrated forcefully the pervasive interdependence of national economies. National autonomy in dealing with economic problems is much less than many realize. The success of efforts to bring inflation under control, achieve satisfactory growth, and maintain a stable international monetary system will depend importantly on cooperative efforts.[25]

The IMF plays an integral role in achieving a sound world economy. Under the new Articles of Agreement, the IMF has been given enhanced responsibility for surveillance over the operation of the international monetary system. The Fund has adopted principles for the guidance of members in conducting exchange rate policy, and procedures and criteria for assessing members' policies (see 1977 and 1978 Annual Reports). The United States believes that the surveillance role constitutes a potentially major strengthening of the IMF's ability to promote sound policies in all countries.

At the IMF annual meeting in September 1979, the Secretary of the Treasury proposed consideration of several steps to strengthen Fund surveillance.[26] These include procedures for measuring individual country performance against agreed global standards; requiring countries with large imbalances, surplus or deficit, to submit for IMF review an analysis of how they propose to deal with the imbalances; a more active role for the IMF Managing Director in initiating consultations with members; and establishment of a Governors Council with decisionmaking powers to replace the advisory Interim Committee.

With greater interdependence among nations has also come a greater balance in terms of economic size. While the dollar remains the central currency for international reserves and liquidity, other currencies have an enhanced capacity for an international role. The development of a multiple currency system, however, would have an undesirable potential for instability and disruption. Consequently, there was increased interest in the fiscal year in multilateral efforts to manage global liquidity.

[25] See exhibit 61.
[26] See exhibit 71.

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Interest has centered on efforts to promote the role of the SDR, the reserve asset created by the IMF in 1969 as a supplementary source of liquidity. As noted in previous Annual Reports, the amended IMF Articles establish the objective of making the SDR the principal reserve asset in the monetary system and provide for the SDR to replace gold as the numeraire for the system and the unit of account and vehicle for many IMF transactions.

During the fiscal year, the IMF took a number of additional steps to promote the SDR. Allocations of SDR's have been resumed, with SDR 4 billion being distributed annually during the 1979-81 period. In January 1979 the United States received SDR 874 million as its share of the initial distributions under this allocation. The interest rate on the SDR has been brought more in line with market rates, and the number of transactions in which SDR's may be used has been expanded, thus improving the SDR's ability to compete with other reserve assets.

The IMF is now considering the establishment of a substitution account under which dollars and possibly other currencies could be exchanged for SDR-denominated assets. The Interim Committee, at its meeting in Belgrade, concluded that a properly designed account could contribute to improving the system and promoting the role of the SDR, and requested a further report from the Fund's Executive Board next April.[27]

The United States believes that the development of a substitution account could offer a number of attractions for the international community in general. The SDR is a diversified instrument, inherently involving less exchange risk than holdings of a single national currency. A substitution account could provide an internationally sanctioned, nondisruptive means for countries to achieve a desired reserve portfolio composition without having to hold a number of national currencies. Implementation of an account would constitute a significant step toward wider use of the SDR and to its longer term development as the principal reserve asset.[28]

There are, however, many difficult questions in the construction of such an account and on sharing the costs associated with operating it. For example, questions must be answered concerning the interest rate and liquidity of the assets issued by the account, the investment of the dollar deposits and the amount and use of interest earnings, and measures to maintain the capital position of the account. These are exceedingly complex issues and we cannot be certain when, or whether, satisfactory answers will be found. Nevertheless, the United States considers the effort worthwhile and is participating in a cooperative, constructive fashion.

IMF operations

Net use of IMF resources during fiscal 1979 remained at the reduced levels of the previous year. Although there was a sharp rebound in total gross

[27] See exhibit 63.
[28] See exhibits 65 and 70.

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drawings (purchases) to 1977 levels, the amount of repayments (repurchases) also increased sharply.

General Resources Account.—Total gross drawings by IMF members in fiscal 1979 from the General Resources Account (including use of reserve tranches) amounted to SDR 3,969 million by 36 countries, compared with SDR 1.3 billion by 31 countries in fiscal 1978 and SDR 4 billion by 36 countries in 1977. The largest portion of these drawings was accounted for by the U.S. drawing of the equivalent of SDR 2,275 million in German marks and Japanese yen from its reserve tranche in November 1978. (At the close of the fiscal year the U.S. reserve position in the IMF amounted to SDR 971.5 million.) A part of this drawing, SDR 777 million, was financed through the General Arrangements to Borrow (GAB), which was activated for this purpose. Other large purchases were made by Yugoslavia (SDR 268 million), the Philippines (SDR 173 million), Peru (SDR 152 million), and Jamaica (SDR 137 million). The drawings were made predominately in special drawing rights (SDR 1,286 million), German marks (SDR 1,619 million), and Japanese yen (SDR 798 million). The U.S. reserve tranche drawing accounted for SDR 1,519 million of the German marks drawn and SDR 756 million of the Japanese yen. Use of U.S. dollars in IMF drawings during the fiscal year amounted to SDR 78.5 billion, compared with SDR 60 million in fiscal 1978.

Of the total SDR 3,969 million in gross purchases from the General Resources Account in fiscal 1979, purchases in the reserve and credit tranches accounted for SDR 3,057 million, or 77 percent of the total. Financing amounting to SDR 248 million was provided for these drawings from the Supplementary Financing Facility (SDR 170 million associated with regular credit tranche drawings and SDR 78 million associated with Extended Fund drawings). Purchases under the compensatory financing facility totaled SDR 484 million; drawings under the Extended Fund Facility amounted to SDR 50 million.

Repayment of outstanding drawings (repurchases) again set a record total of SDR 5 billion in fiscal 1979, compared with SDR 3.6 billion in the previous year. Repurchases by Italy (SDR 1.1 billion) and the United Kingdom (SDR 1.7 billion) accounted for over half of total repurchases, and eliminated the outstanding credit tranche drawings by the United Kingdom, the oil facility drawings of Italy, and a portion of the United Kingdom's oil facility drawings. Large repurchases were also made by Spain (SDR 428 million), Korea (SDR 149 million), and Mexico (SDR 126 million). Currencies used in the repurchases included U.S. dollars (SDR 1,939 million), German marks (SDR 1,382 million), and Japanese yen (SDR 898 million). In addition, SDR 643 million of special drawing rights were used in repurchases.

As of September 30, 1979, cumulative drawings of IMF resources (reserve and credit tranches, compensatory financing, oil, buffer stock and extended fund facilities, and including supplementary financing), from the beginning of IMF operations, amounted to SDR 50 billion, of which SDR 14 billion was in

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U.S. dollars. Cumulative repurchases amounted to SDR 30.5 billion, of which SDR 9.8 billion was in dollars.

General Arrangements to Borrow.—As noted above, the GAB was activated to finance a portion of the U.S. reserve tranche drawing of November 1978. Of the SDR 777 million obtained from the GAB, the equivalent of SDR 582.9 million was in German marks and SDR 194.3 million was in Japanese yen.

[At their meeting on October 1, 1979, the Ministers and Governors of the Group of Ten agreed to renew the GAB without major change for a further 5 years from October 24, 1980.]

Special Drawing Rights Department.—Activity in the SDR Department reached another record level; total use by participants amounted to SDR 5,596 million during fiscal 1979, more than double the previous year's level. Transfers of SDR's by participants to other participants totaled SDR 2,763 million. These transfers included transfers between members by agreement and transfers with designation. Transactions between members by agreement, totaling SDR 1,538 million, included the sales of SDR by the United States to Germany (SDR 600 million) and to Japan (SDR 500 million) in November 1978.

Transfers by participants to the General Resources Account amounted to SDR 1,339 million, only slightly larger than in the previous year. These transfers occurred primarily for the purpose of making repurchases and payment of interest and charges on drawings. Use of SDR's by the General Resources Account amounted to SDR 1,494 million, to finance drawings by members and in payment of remuneration to creditors in the General Resources Account. As a result of all SDR transactions of the General Resources Account, the Account's SDR holdings declined by SDR 115 million during the fiscal year, to SDR 886 million as of September 30, 1979.

IMF gold sales.—During fiscal 1979, the IMF continued its gold sales program under which 25 million ounces are being sold to members at book value (SDR 35 per ounce) and 25 million ounces are being sold at public auction for the benefit of developing countries.

In January/February the IMF sold a total of 6.12 million ounces to members at the book value. The United States received 1,433,517 ounces. A total of 18.35 million ounces have been sold in this manner since the program began.

The IMF held 12 monthly public auctions in fiscal 1979, at which a total of 5.53 million ounces of gold were sold, bringing total sales in the auction program to 19.97 million ounces as of September 30, 1979. The profits received from sales in fiscal 1979 equaled approximately $1.203 billion, bringing total profits accrued from all auctions to approximately $2.97 billion.

Trust fund.—The profits on the auction sales of 25 million ounces of IMF gold are being placed in a trust fund for the benefit of developing country members. The trust fund is legally separate from the IMF but managed by it as trustee. A portion of the gold sales profits accruing to the trust fund is being transferred directly to each eligible country in proportion to its quota.

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The balance of the profits is being used to finance balance of payments loans on concessional terms to the poorest developing countries.

The third direct distribution of trust fund profits was made to 104 eligible members in July 1979. The amount transferred totaled approximately $1.4 billion and represented a portion of the profits on the sale of 8.1 million ounces of gold. Two further disbursements of trust fund loans were also made during the fiscal year to 29 countries, totaling SDR 358 million and bringing total loan disbursements under the program to approximately SDR 1.2 billion.

Oil facility subsidy account.—This account was established in 1975 to assist the Fund's most seriously affected members to meet the cost of using the 1975 oil facility. The objective of the account, financed by voluntary contributions from 24 members plus Switzerland (the United States did not contribute) and administered by the IMF as trustee, is to reduce the effective rate of annual charge payable on drawings under the 1975 facility by about 5 percentage points per year (from roughly 7.2 percent to 2.2 percent). The oil facility ceased new lending operations in 1976. Subsidy payments totaling SDR 19.1 million were made during the fiscal year, bringing cumulative payments to SDR 85.4 million.

Participation in the OECD

Secretary Blumenthal attended the annual meeting of the OECD Council at Ministerial Level in Paris on June 13–14.[29] The Ministers decided to continue the concerted action program adopted at the previous Ministerial; agreed on guidelines for economic and energy policies over the medium term; reaffirmed their commitment to the 1976 agreements on international investment and multinational enterprises; and renewed the trade pledge.

OECD bodies which played a key role in review of these issues during the year preceding the Ministerial included the Economic Policy Committee (EPC) and its various working parties; the International Energy Agency (see "Commodities and Natural Resources"); and the Committee on Investment and Multinational Enterprises and the Trade Committee (see "Trade and Investment").

Economic policy.—During their 1979 review of the concerted action program, Ministers concluded that the program had yielded positive results in terms of more internationally balanced economic growth, reduced payments imbalances, and greater exchange rate stability. Even so, renewed inflation and the worsening energy situation were major obstacles to achieving sustained economic growth in OECD countries. Ministers recognized that economic and energy policies had become inseparable and policy guidelines were needed for both the short and medium term. For the short term, Ministers agreed on the need for a cooling-off of the U.S. economy and maintenance of domestic demand growth in the rest of the OECD area; agreed to reduce member countries' demand for oil on the world market by

[29] See exhibit 67.

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some 2 mb/d; agreed that higher oil prices should be passed on to energy users; agreed that an effort must be made to gain acceptance of the fact that higher oil prices reduce the scope for achieving higher real incomes; and, finally, agreed that closer monetary cooperation should be continued.

For the medium term, Ministers agreed on the need for cautious demand management policies; actions to improve the energy supply side; use of positive adjustment policies; an open world trading system; and better functioning of commodity markets. Concerning the energy constraint, Ministers recognized that the long-term trend of real energy prices is almost certainly upwards; and agreed that policies to encourage both energy conservation and production were needed.

These economic policy guidelines approved by the 1979 Ministerial were developed largely by the OECD's Economic Policy Committee. Treasury officials participated actively during fiscal 1979 in the work of the EPC and of its several working groups on growth, inflation, short-term economic prospects, and external balance. New EPC groups, devoted to energy and to problems of medium-term adjustment, were formed during the course of the year. Charles L. Schultze, Chairman of the U.S. Council of Economic Advisers, continued to serve as chairman of EPC during this period. The full committee met twice, in November 1978 and May 1979.

WP-3 (External Balance).—Concerns of this working party during fiscal 1979 included the progress being made toward reduction of payments imbalances; the November 1, 1978, monetary and exchange measures taken by the United States; the establishment of the European Monetary System; and the impact of higher oil prices on international trade and payments. Under Secretary for Monetary Affairs Solomon represented the United States at the November 1978 and May 1979 meetings; Assistant Secretary Bergsten was the U.S. representative at the February and July 1979 meetings; and Deputy Assistant Secretary Widman at the September 1979 meeting.

Energy.—At its May 1979 meeting, the EPC established an Ad Hoc Group on the Energy Situation to evaluate the implications of the energy situation for macroeconomic policy. The group met twice, in July and September. Its report formed a basis for ongoing discussions of the relationship of energy and macroeconomic policies in the EPC.

Positive adjustment.—Work on positive approaches to medium-term structural adjustment continued to be carried on throughout this period by the EPC and by a number of the sectoral committees such as Industry, Agriculture, and Trade. At its June 7, 1979, meeting, the OECD Council established a special program of work for the OECD on positive adjustment policies, and created a high-level Special Group on Positive Adjustment Policies, attached to the EPC. Treasury participated actively in the work of the new special group.

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Economic summits

Treasury officials participated actively in bilateral and multilateral summit activities during the year. Secretary Blumenthal accompanied President Carter and others to the seven-nation economic summit held in Tokyo June 28–29. Secretary Blumenthal also participated in the U.S./Japan bilateral economic summit in early May, hosting a Cabinet-level breakfast for Prime Minister Ohira in his capacity as EPC Chairman.

International investment and capital flows (OPEC investors)[30]

In 1978, investments and transfers by OPEC member countries declined to about $14.75 billion from an estimated $38.25 billion in 1977. The decline in placements reflected a sharp drop in the current account surplus for some member countries and widening deficits for others. The investable surplus from the combined current accounts was supplemented by funds from net borrowings that nearly doubled from 1977.

From June 1978 to June 1979 OPEC countries placed about $15 billion in foreign markets. The Eurobanking market took the largest proportion as OPEC countries initially placed funds in bank deposits and later shifted to longer term instruments. Holdings in the United States declined, primarily reflecting some liquidation of holdings of U.S. Government securities. Transfers and loans to developing countries were substantial and growing.

Investable funds were expected to rise sharply in the second half of 1979 as oil-price increases swelled revenue collections. By the third quarter this trend was becoming evident in the data on OPEC placements in the United States. OPEC investments in U.S. Treasury bills and in commercial bank deposits were large enough in July and August to reverse the first-half decline in OPEC holdings and registered a significant increase during the first three quarters combined.

Developing Nations

Situation of the non-OPEC developing countries

During 1978 and 1979, the aggregate current-account deficit of non-OPEC less developed countries (LDC's) grew under the influence of rising import demand, sluggish growth in export markets, and large oil-price increases in 1979. The current-account deficit, including official unrequited transfers, is estimated to have reached $31 billion in 1979, nearly twice the 1977 deficit of $16 billion and well above the estimated 1978 deficit of $22 billion.[31]

The direct contribution of oil purchases to the current-account deficits is suggested by oil-trade data for 24 major non-OPEC LDC's. These data indicate that net oil imports for the group were about $12 billion in 1978 and $16 billion in 1979. The influence of increased nonoil import costs and slower growth in developed-country markets is represented by OECD inflation rates

[30] See exhibits 69 and 77 (Bergsten, July 30, 1979).

[31] Excluding official unrequited transfers, the current-account deficit for 136 non-OPEC LDC's was about $25 billion in 1977, $34 billion in 1978, and $46 billion in 1979.

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of 6.9 percent and 8.5 percent in 1978 and 1979, respectively, and by OECD growth of 3.7 percent and 3 percent in the same 2 years.

The large current-account deficits of the last several years correspond to relatively healthy growth rates for the developing countries during this period. In 1978, real GNP growth for the group of 24 major LDC's increased to 5.7 percent, from 5.2 percent the year before, and was maintained at nearly the same rate, 5.6 percent, in 1979.

Inflation in the non-OPEC LDC's was generally contained in 1978 but worsened in 1979, partially under the influence of increases in the prices of oil and nonoil imports. The GNP-weighted average inflation rate for the group of 24 LDC's held firm at 33 percent in 1978, then rose 4 points to 37 percent in 1979.

Although the non-OPEC LDC current-account deficits were large in 1978 and 1979, financing for the deficits was plentiful. With loan demand relatively weak in the developed countries, bank financing was available on exceptionally favorable terms to qualified LDC borrowers. Net private financial flows to non-OPEC LDC's swelled to about $24 billion in 1978, from 1977 flows of $14 billion, and in 1979 net private financing continued at an estimated rate of $25 billion. Official financial flows, including official unrequited transfers, to the non-OPEC LDC's, were slightly larger than private flows during these 2 years, amounting to about $26 billion in 1978 and $27 billion in 1979.

Net financial flows to non-OPEC LDC's were more than sufficient in the aggregate to cover the current-account deficits in 1978 and 1979. In fact, the gross reserves of these countries increased almost 30 percent in 1978 to a level of $66 billion, the third straight year of large reserve increase. In 1979, however, the rate of increase is expected to slow to $6–$8 billion.

The external debt of the non-OPEC developing countries continued to rise quite rapidly in 1978 and 1979, reflecting the large increases in borrowing by these countries. Debt-service payments increased somewhat more rapidly than total indebtedness, because of a shift over the past 5 years toward debt from private sources. Since the export earnings of these countries also grew quite rapidly during this period, the aggregate debt-service ratio for these countries did not change greatly, although the trend of this indicator is clearly upward. More importantly, the distribution of the debt suggests that it is falling most heavily on those countries that have the greatest capacity to bear it, and whose economic prospects are the brightest.

Development Committee

Discussions and negotiations between the developed and developing countries, known collectively as the North-South dialog, take place in a variety of forums. The United Nations Conference on Trade and Development (UNCTAD) and the Committee of the Whole explore a broad range of international economic issues. Specialized forums, most under U.N. auspices, explore specific issues such as commodities, trade, investment, technology transfer, and debt. The IBRD/IMF Development Committee, on which the

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United States is represented by the Secretary of the Treasury, is one of these forums.

The Development Committee was established in 1974 by the Governors of the IBRD and the IMF to maintain an overview of the development process and to consider all aspects of the question of the transfer of real resources to developing countries. Its membership of 20 Finance Ministers, roughly evenly divided between industrialized and developing countries, makes it a valuable forum for high-level discussion of key development finance issues. Several organizational reforms, instituted early in 1979, call for a more active involvement by the IBRD and the IMF in providing both staff analysis and policy direction for the work of the Committee. Additional measures were taken to assure that the Committee focused its work on key selected issues which could lead to specific policy recommendations by the members. The United States strongly supported these reforms.

The 12th meeting of the Development Committee, held on September 30, 1979, in Belgrade, considered papers prepared by the staff of the IBRD and the IMF on the flow of financial resources to the developing countries and the stabilization of export earnings, the two principal agenda items. Most of the discussion was devoted to proposals to strengthen the ability of existing institutions—notably the Bank and the Fund—to respond to emerging financial needs of developing countries. The Committee endorsed the IBRD's consideration of an increase in program lending and expanded collaboration with the Fund in dealing with payments problems of developing countries, and requested the Bank Board to explore criteria to govern program and sector lending to countries where external disequilibria had not yet become severe. The Committee also suggested that the Fund Board reconsider the proposal to extend the repayment period under the Extended Fund Facility from 8 to 10 years, and to examine the advisability of lowering the interest costs of the Supplementary Financing Facility in view of possibly heavy borrowing by low-income countries in the coming years.

On the subject of export earnings stabilization, the Committee welcomed the recent liberalization of the compensatory financing facility and the new agreement expanding the European Communities' STABEX facility, and noted the progress being made in the common fund negotiations.

During the year, a Development Committee Task Force on Private Foreign Investment was established, the first to be created following the reform of the Committee. The task force was set up to continue the work previously undertaken by the Working Group on Access to Capital Markets on the role of direct foreign investment in development. The task force first met in June 1979, under the chairmanship of Treasury Assistant Secretary Bergsten, and included representatives from Australia, Brazil, France, Germany, India, Kuwait, Mexico, the Philippines, Switzerland, and the United Kingdom. A second meeting was held in early October in Belgrade following the IBRD/IMF annual meetings, and future meetings are scheduled through mid-1980. The task force is focusing its work on policies of both

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home and host countries as they affect private direct investment flows, and research and policy papers are being prepared by task force members as well as outside consultants.

Delinquent debt[32]

As of September 30, 1979, the outstanding long-term principal on post-World War II debts, derived mostly from foreign aid and export credit programs of the U.S. Government, totaled $48 billion. This indebtedness is broken down as follows: (1) $22.8 billion contracted under the Foreign Assistance Act (and predecessor legislation), (2) $13.8 billion contracted under the Export-Import Bank Act and the Commodity Credit Corporation Act, and (3) $7.5 billion contracted under Public Law 480. An additional $1.3 billion stems from activities directly related to World War II—primarily lend-lease and surplus property disposal programs.

Since World War II, the vast majority of these debts have been paid on time. During fiscal 1979, the United States collected over $5 billion of principal and interest payments due on long-term credits, and the equivalent of $250 million in principal and interest payments on loans repayable in foreign currencies. As of September 30, 1979, principal and interest due and unpaid 90 days or more on post-World War II debt amounted to $676.1 million. More than two-thirds of this delinquent debt is subject to special political or other factors, as in the case of Vietnam and Cuba, which make prompt payment unlikely at this time.

Foreign outstanding indebtedness to the U.S. Government resulting from World War I totaled approximately $25.9 billion as of September 30, 1979, of which $23.2 billion was delinquent. The collection of this debt presents special problems. Most debtor countries fulfilled their commitments under the debt agreements until 1933-34, but have made no payments since. Aside from the Soviet Union, which repudiated all foreign debts in January 1918, the principal debtor governments have never denied the validity of the debts. However, these nations have steadfastly maintained that they would only resume payments on their war debts to the United States on condition that the issue of Germany's war reparations was satisfactorily settled. Resolution of the problem of government claims against Germany arising from World War I has been deferred "until a final general settlement of this matter" by the 1953 London Agreement on German external debts, to which the United States is a party. This agreement was ratified by the U.S. Senate and has the status of a treaty.

As a result of amendments, passed in 1978, to the Foreign Assistance Act of 1961, Treasury's report to Congress on developing countries' external debt and debt relief provided by the United States has been discontinued. However, this information is now provided to Congress in the annual Foreign Assistance Report submitted by the Chairman of the Development Coordina-

[32] See exhibit 77.

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tion Committee. Part Five of this year's report is comprehensive, containing detailed information on the debt situation of major debtor countries and the means by which the United States and other creditor countries have dealt with debt-service problems.

Debt rescheduling

During fiscal 1979, the United States participated in multilateral debt reschedulings for Peru, Turkey, and Togo.

The United States and 13 other official creditors met in Paris on November 2 and 3, 1978, to consider Peru's request for debt relief during calendar years 1979 and 1980. In view of Peru's severe debt-servicing difficulties and the Government's effort to stabilize the economy through implementing new economic and financial policies, negotiating a standby arrangement with the IMF, and concluding a refinancing arrangement with its private bank creditors, the official creditors agreed to reorganize 90 percent of the principal payments falling due during 1979 and 1980. Relief in 1980 was made contingent on Peru's reaching agreement with the IMF on the policies to be implemented in 1980 and on the quantitative targets for the 1980 standby program.

The United States subsequently negotiated a bilateral agreement, signed in Lima on July 5, 1979, implementing the terms of multilateral understanding. Under the terms of the bilateral agreement, payments to be rescheduled by the United States totaled $55.5 million in 1979 and $49.7 million in 1980. The amounts rescheduled in 1979 are to be repaid in 8 years, including a 3-year grace period. The weighted average interest rate charged by the United States is 8.3 percent for the rescheduled 1979 obligations. Under the multilateral arrangement, other Paris group creditors are expected to provide up to $475 million of debt relief to Peru. Due to unforeseen improvements in its external payments situation, Peru has elected not to avail itself of the debt relief agreed to by its creditors for 1980.

Nine of Togo's principal official creditors, including the United States, met in Paris on June 14 and 15, 1979, and agreed to reorganize 80 percent of the principal and interest payments falling due prior to and remaining unpaid as of April 5, 1979, and falling due during the period April 6, 1979, through December 31, 1980. Debt relief for the 9-month period April through December 1980 is contingent on Togo reaching understanding with the IMF on quantitative targets for the 1980 standby program. The rescheduled payments are to be repaid in 9 years and 9 months, including a 3-year and 9-month period of grace.

The United States is currently in the process of negotiating a bilateral agreement with Togo which will reschedule $1.4 million of payments due to Eximbank during the period April 6, 1979, through March 31, 1980, and $0.7 million in arrears. The United States will not reschedule debt-service payments falling due in the period April through December 1980 since the amount of these payments is less than the minimum amount established in the

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multilateral agreement. The interest rate being charged on the rescheduled debt is 8.125 percent.

For the second year in a row, Turkey's principal official creditors met in Paris (July 23 through 25), in the context of a working party of the OECD-led consortium for Turkey to consider Turkey's request for debt relief. The creditors agreed, in light of Turkey's continuing economic and financial problems, to reorganize 85 percent of principal and interest payments due during the period July 1, 1979, through June 30, 1980. The creditors also agreed to reorganize arrears on short-term debt which fell due during the period May 21, 1978, through June 30, 1979. The United States does not hold any of these short-term arrears.

On December 11, 1979, the United States signed a bilateral rescheduling agreement with Turkey to implement the multilateral understanding. Under the terms of the bilateral agreement, payments rescheduled by the United States totaled $195.4 million. The weighted average interest rate charged by the United States is 6.7 percent. The rescheduled amounts are to be repaid in 9 years, including a grace period of 4 years. Under the multilateral arrangement, other creditors are expected to provide about $850 million of debt relief to Turkey.

Local currency management

One of the responsibilities of the Secretary of the Treasury is to determine which foreign currencies held by the United States are in excess of normal U.S. Government requirements. The purpose of this determination is to assure maximum use of local currencies in lieu of dollars for U.S. programs in the countries concerned. For fiscal 1980, Burma, Egypt, Guinea, India, and Pakistan will remain on the excess currency list.

As U.S. foreign currency receipts decrease and in-country expenses increase, currencies lose their excess status. When countries are removed from the excess list, special foreign currency programs in those countries are phased out. These programs involve scientific and research projects which usually have some political benefit to the United States but, because of their lower priority, might not be funded were it not for the availability of excess currencies.

Development assistance policy

The Department of the Treasury, in addition to its responsibilities with regard to the multilateral development banks, participates in the formulation of U.S. development assistance policy through its membership in the National Advisory Council on International Monetary and Financial Policies, in the Development Coordination Committee (DCC), and in various other interagency committees designed to coordinate economic assistance programs. Treasury's principal concerns are to promote the efficient utilization of development assistance resources and to assure that bilateral aid objectives

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and programs remain consistent with overall U.S. economic interests and with U.S. multilateral aid efforts, in particular.

As a member of the DCC, Treasury has actively supported measures taken in early 1978 to strengthen that Committee's policy coordinating role. Treasury participates in each of four subcommittees which treat issues in the specific areas of multilateral assistance, bilateral assistance, food aid, and international organizations. As a reflection of its special responsibilities for U.S. policy toward the multilateral development banks, a Treasury official has served as chairman of the DCC Subcommittee on Multilateral Assistance, which this year considered the World Bank's proposal on graduation policy and formulated U.S. Government policy on cofinancing, local currency financing, and program lending in the multilateral banks. The Subcommittee's Working Group on Multilateral Assistance continued its ongoing review of development projects proposed by the banks.

In addition to the work of its Subcommittees, the DCC undertook several country strategy reviews focusing on development problems of selected high-priority countries. The purpose of these reviews is to formulate a coherent U.S. development assistance strategy toward individual countries, integrating a full range of programs and policies. During the year, the DCC conducted strategy reviews on Nigeria, Indonesia, the Philippines, and Brazil.

Another highlight of DCC work this year was its review of U.S. assistance policies toward the middle-income countries. In this review, the DCC examined issues concerning the allocation of concessional bilateral aid funds, the patterns of multilateral development bank lending, and the role of nonconcessional development programs for the middle-income group of developing countries. The conclusions of this review formed the basis of a DCC report to Congress which had been requested by the House Committee on International Relations.

Parallel to Treasury's active participation in the ongoing work of the DCC, it was also directly involved in the interagency consultations leading to the establishment on October 1, 1979, of the International Development Cooperation Agency (IDCA). The decision to create IDCA concluded a lengthy examination of how to strengthen the organizational framework for development assistance policy. By providing a central focus for policy and budget issues, IDCA is intended, inter alia, to facilitate coordination between bilateral and multilateral aid programs.

Relations with developing nations[33]

OPEC.—The combined current account surplus (including official transfers) of the 13 members of OPEC is estimated to have increased dramatically to over $65 billion in 1979, from near balance in 1978. The increase resulted from large OPEC oil price increases, related primarily to the instability in Iran, and a slowing in the growth of OPEC imports. The surplus continued to

[33] See exhibits 72, 75, and 77.

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be almost entirely concentrated in six Persian Gulf countries (Saudi Arabia, Kuwait, Iran, Iraq, Qatar, and the United Arab Emirates).

OPEC oil earnings (government-take basis) totaled about $130 billion in 1978 and rose to roughly $200 billion in 1979. Generally, slower economic activity and conservation in major oil-consuming countries, along with increased non-OPEC production and a drawdown of stocks, contributed to a decline of almost 5 percent in OPEC oil production during 1978.

The disruptions in Iran which began in late 1978 resulted in a complete halt of Iranian oil exports during the first 2 months of 1979. Subsequently Iranian oil exports were restored to a level substantially lower than the 1977–78 levels. However, increased oil exports by other OPEC member countries, particularly Saudi Arabia and Iraq, offset the diminished Iranian flows so that average OPEC oil production during the first half of 1979 was more than 5 percent above OPEC average production during the same period in 1978. For 1979 as a whole, the volume of OPEC oil output is expected to be 3 to 4 percent above the 1978 average level.

Following a year of fairly constant OPEC oil prices, it was decided at the OPEC ministerial meeting in December 1978 that OPEC oil prices would be increased during 1979 to a fourth-quarter level 15 percent above the yearend-1978 level. The increase, to some extent, was a response to the initial market pressures stemming from the disruption in Iranian production. However, the deepening uncertainties regarding the Iranian situation contributed to growing pressures in unsettled international oil markets, and OPEC oil prices had increased almost 60 percent by mid-1979. At the OPEC ministerial meeting in June 1979, a maximum price for OPEC oil was set at $23.50 per barrel; however, prices for oil from some member countries had exceeded that level by October. [By the end of December 1979, OPEC official prices had doubled from yearend 1978.]

It is estimated that the aggregate value of OPEC imports grew at less than 7 percent in 1979, to over $105 billion. The growth rate was lower than the almost 12-percent increase during 1978, and this reflected a sharp drop in Iranian and Nigerian imports, which more than offset marginally higher growth of imports by the rest of OPEC. For Iran, political disruption and paralysis of governmental economic policies and programs underlay the reduction in imports. In Nigeria, the government responded to a falling level of foreign exchange reserves by undertaking measures to reduce imports.

Africa.—Treasury officials maintained an active role in U.S. economic relations with Africa during the year. Assistant Secretary Bergsten met with senior officials from Zaire and Ghana on several occasions to review their efforts to stabilize their economies. Deputy Assistant Secretary Nachmanoff visited Dakar May 11 and 12, 1979, to confer with leaders on current economic problems in Senegal and throughout the Sahel region.

Middle East.—Secretary Blumenthal visited the Middle East in late November 1978 to discuss a wide range of economic and financial issues with officials of Saudi Arabia, the United Arab Emirates, Iran, and Kuwait. The

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trip represented a continuation of the administration's dialog with those important countries. In Saudi Arabia the Secretary also cochaired a session of the United States-Saudi Arabian Joint Commission.

Latin America.—In October 1979 Secretary Miller met with Finance Minister Ibarra and other Mexican officials to discuss customs affairs, tax matters, access to capital markets, and possible measures to help deal with economic problems in developing countries. During the summer Under Secretary Solomon visited Mexico for a meeting with President Lopez Portillo to review the results of the Bonn economic summit meetings and to converse on multilateral trade matters. Assistant Secretary Bergsten visited Mexico in June to chair a comprehensive meeting of the Finance Working Group of the U.S.-Mexico Consultative Mechanism and to meet with several cabinet officials to discuss the MTN subsidies code, General Agreement on Tariffs and Trade issues, and the antidumping petition on Mexican winter vegetables.

In November 1978, Assistant Secretary Bergsten completed a major bilateral trade accord with Brazil whereby the United States agreed to waive countervailing duties on Brazilian textile exports in exchange for a 1-year phaseout of Brazil's tax credit subsidies on those products. The Brazilian Government also announced its intention to work actively with the United States to conclude the MTN negotiations on a subsidy code.

During 1979, Secretaries Blumenthal and Miller and Under Secretary Solomon also held ministerial-level meetings with Brazilian officials to discuss key world financial and energy issues.

In February, Secretary Blumenthal met with a delegation of senior advisers to Venezuelan President-elect Herrera. The representatives outlined the key policy priorities of the new Venezuelan administration and exchanged views with the Secretary on monetary, trade, and energy issues.

The Department of the Treasury participated, along with a number of other U.S. agencies, in bilateral economic consultations with representatives of the Government of Argentina during October in Washington. These talks, designed to renew a dialog initiated by a joint commission in 1967, covered a broad range of economic issues and further advanced bilateral consultations in the MTN and initiated a proposal for a bilateral tax treaty.

Secretary Blumenthal met with Peruvian government officials in Washington in March to discuss Peru's economic progress, U.S. economic assistance, and tax credits for U.S. oil companies operating in Peru.

Asia.—Secretary Blumenthal accompanied President Carter to Korea June 30–July 1. During the visit, the Secretary had meetings with the key economic ministers of the Korean Government. The talks covered the global economy, energy, and the dollar and specific trade matters such as the orderly marketing agreement on color televisions and Korean participation in the MTN.

In Washington, Secretary Blumenthal met with Prime Minister Lee of Singapore and Korean economic ministers. Secretary Blumenthal and

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Assistant Secretary Bergsten participated in a seminar in late June entitled "Korea Business Future," sponsored by the Center for Strategic and International Studies.

Deputy Assistant Secretary Nachmanoff attended the first meeting of the U.S. chapter of the U.S.-ASEAN Business Council on February 8.

In September Secretary Miller met in Washington with Philippines Minister of Finance and Chairman of the IMF/IBRD Development Committee Virata to discuss the IMF, the World Bank, regional banks, and bilateral issues concerning trade and investment.

Treasury officials participated in the fourth session of the India-United States Joint Commission held in Washington April 24, 1979.

Multilateral development banks[34]

During fiscal 1979, the administration requested appropriation of funds for U.S. participation in the multilateral development banks for fiscal 1980. A breakdown of the request is shown in the table below. At the end of fiscal 1979, final congressional action on the request was pending.

Appropriation request for U.S. participation in the multilateral development banks during fiscal 1979
[$ millions]

Institution	Fiscal 1980 appropriation request	Comment
International Bank for Reconstruction and Development:		
Paid-in	102.6	Third installment of U.S. contribution to IBRD selective capital increase authorized in fiscal 1977. $452.5 million callable and $50.3 million paid-in remains to be appropriated for the second installment.
Callable	923.2	
International Development Association	1,092.0	$800 million represents the third and final installment of the U.S. contribution to the fifth replenishment of IDA. $292 million represents the U.S. contribution to IDA's fourth replenishment.
International Finance Corporation	33.4	Third installment of U.S. contribution to IFC authorized in fiscal 1977.
Inter-American Development Bank:		
Paid-in	51.5	First installment of U.S. contribution to new IDB replenishment.
Callable	635.8	
Fund for Special Operations	325.3	$150.3 million remains to be appropriated from replenishment authorized in fiscal 1976.
Asian Development Bank:		
Paid-in	24.8	Third and final installment of U.S. contribution to second ADB capital increase authorized in fiscal 1977. $40.3 million callable and $4.5 million paid-in remains to be appropriated for the second installment.
Callable	223.6	
Asian Development Fund	171.2	The first installment of U.S. contribution to the new replenishment and a portion of U.S. contribution to the previous ADF replenishment.
African Development Fund	41.7	First installment of U.S. contribution to the new AFDF replenishment.
Total	3,625.1	

[34] See exhibits 73, 74, and 77.

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At the end of fiscal 1979, legislation was also pending in Congress to authorize U.S. participation in replenishments and increases in resources for the Inter-American Development Bank, the Asian Development Fund, and the African Development Fund. The total amount being requested for these three regional institutions was $4,019 million and covered U.S. subscriptions and contributions to be made over a 3- to 4-year period beginning in fiscal 1980. A breakdown of the authorizing legislation as it was submitted to Congress is shown in the following table:

Authorization request
[$ millions]

	Authorization amounts	U.S. share of replenishment
		Percent
Inter-American Development Bank capital	2,749	34.5
Inter-American Development Bank:		
Fund for Special Operations	700	40
Asian Development Fund	445	20.7
African Development Fund	125	17.5
Total budget authority	4,019	

The multilateral development banks committed $13,356 million to developing countries in fiscal 1979. The distribution of these commitments by institution was as follows: World Bank group, $10,133 million; Inter-American Development Bank, $2,029 million; Asian Development Bank, $986 million; and the African Development Fund, $208 million.

Participation in the multilateral development banks is an efficient and cost-effective way for the United States to help promote economic growth and social development in less developed countries. All lending operations are based on sound financial and operational criteria; each proposal must pass through a detailed and rigorous appraisal process, thus assuring that the greatest developmental impact is obtained from every dollar lent.

The United States shares the burden for providing economic assistance with other donor countries. These countries provide $3 for every dollar contributed by the United States. In addition, 70 percent of the banks' total lending requirements are met by borrowings from private capital markets. These borrowings are backed by callable capital subscriptions which do not result in actual budgetary outlays by the United States or other donor countries. In the case of the World Bank, each dollar paid in by the United States has led to $50 of Bank lending.

There are also substantial financial and economic benefits which accrue directly to the United States as a result of participation in the multilateral

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development banks. In the case of the World Bank, the United States pays in 2 cents for each dollar loaned out by the Bank and gains 18 cents in procurement contracts awarded to U.S. firms, thus increasing income and employment levels in the domestic economy. There are also significant indirect benefits to the U.S. economy as a result of the increased growth of less developed countries which is fostered by bank lending activity.

The multilateral development banks also have been extremely responsive to U.S. policy initiatives that a greater effort be made to help meet basic human needs in recipient countries and to ensure the participation of the poor in the benefits of development. In the field of energy, the banks have also acted to meet basic U.S. policy concerns and placed greatly increased emphasis on lending programs to expand and diversify alternative sources of energy in non-OPEC developing countries. Over the next 5 years, World Bank lending for energy development is projected to reach about $5.6 billion, and to support projects totaling $19 billion. This volume of lending is expected to result in the production of energy equivalent to 2.1 million barrels of oil a day. When hydroelectric power projects are included, about 20 percent of overall Bank lending during the next 5 years will be for energy purposes.

Over the next several years, the Inter-American Development Bank will be devoting a greater proportion of its lending to help develop geothermal and hydroelectric potential in Latin America, and the Asian Development Bank has embarked on a large lending program to finance the production of primary energy fuels. These bank funds will also have the effect of facilitating additional private investment in this critical area, thus improving the oil supply and demand balance for the world as a whole.

World Bank group

The World Bank group committed a total of $10,133 million for economic assistance to its borrowing member countries in fiscal 1979, an increase of 8 percent over the previous fiscal year. Lending extended on conventional terms from the IBRD amounted to $7,182 million in fiscal 1979, compared with $6,004 million in fiscal 1978, an increase of about 20 percent. New IDA credits, which are made on concessional terms, reached $2,597 million in fiscal 1979, compared with $2,858 million in fiscal 1978. IFC commitments were $354 million in fiscal 1979, compared with $483 million in fiscal 1978. As of September 30, 1979, total IBRD loan commitments outstanding were $52.9 billion and the comparable figure for IDA credits $17.1 billion. Outstanding IFC commitments totaled $2.5 billion.

During fiscal 1979, the IBRD and IDA continued to place increased concentration on lending for agricultural and rural development. IBRD loan commitments in the agricultural sector in fiscal 1979 were $1,674 million (23 percent of total lending). The amounts committed by IDA for agricultural purposes continued to be the highest of any sector. Other sectors emphasized in IBRD and IDA lending programs for 1979 included development finance, industry, power, transportation, and water supply and sewerage.

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During fiscal 1979, the IBRD and IDA committed resources totaling \$9,771 million involving 251 projects in 74 countries. These resources were distributed by region as follows: Africa, \$1,267 million; Asia, \$3,852 million; Latin America, \$2,277 million; Europe, the Middle East, and North Africa, \$2,375 million. IFC commitments during the same period went to 48 projects in 32 developing countries. These commitments included 9 projects in Europe, the Middle East, and North Africa; 14 projects in Asia; 15 projects in Latin America; and 10 projects in Africa.

At the meeting of the World Bank in Belgrade, Yugoslavia, shortly after the end of fiscal 1979, Secretary Miller noted that the Bank had steadily expanded its activities over the past 10 years and become the largest single source of external finance and technical assistance. He pointed out, however, that capital would always be scarce relative to need and that it was essential for the Bank to stimulate, to the maximum degree, the mobilization of domestic savings in developing countries and the flow of private capital from abroad. He specifically called for the following: Greater emphasis on creating productive job opportunities in rural areas; new approaches to job creation in urban areas and the provision of low-cost basic services to the urban poor; investments in human capital through programs in education, health, and family planning; the reduction of capital investment for each job created; new initiatives to encourage cofinancing; and more ambitious efforts to expand production of energy fuels including new applications for renewable energy technology. At the same time, he indicated his belief that the capital of the Bank should be increased substantially and that the United States would also support a sixth replenishment of resources for the International Development Association.

Lending operations of the IBRD are financed from the following sources: Paid-in capital subscriptions from member countries; borrowings in private capital markets based on the members' callable capital subscriptions; borrowings from governments and central banks; sales of participations; principal repayments on loans; and earnings on loans and investments.

During the Bank's most recent fiscal year, its outstanding funded debt increased by \$3,678 million to reach \$26,280 million as of June 30, 1979. As of that date, estimates indicated that 22 percent of Bank bonds were held by investors in the United States, 25 percent in Germany, 13 percent in Japan, 6 percent in Saudi Arabia, and 16 percent in Switzerland. The remaining 18 percent of outstanding borrowings was held by central banks and government agencies in more than 80 countries. The Bank's borrowing program for its fiscal year 1979 was the equivalent of \$5,085 million; 26 issues totaling the equivalent of \$3,440 million were sold in private capital markets while governments and central banks purchased \$1,629 million, or about 32 percent of the year's total. The principal sources of the Bank's public and private borrowings during its fiscal year 1979 were Germany, Japan, and Switzerland. There were no borrowings in the United States during this period.

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During IBRD fiscal year 1979, the Bank's borrowers repaid $978 million of principal, $843 million to the Bank and $135 million to purchasers of loans. As of June 30, 1979, cumulative repayments on loans were $7,322 million for the Bank and $2,560 million to purchasers of loans. Income on Bank investments amounted to $744 million, up by $130 million, or nearly 21.2 percent, over the previous fiscal year. Income on loans increased by $344 million, or 26 percent, to a total of $1,669 million. For the same period, sales of participations in the Bank's loan portfolio were $45 million, compared with loan sales of $189 million in fiscal 1978. Net income of the Bank in IBRD fiscal 1979 was $407 million, up $169 million, or nearly 71 percent, from the previous fiscal year.

During fiscal 1979, the United States participated with other member countries in discussions regarding a sixth replenishment of resources for the International Development Association. It is expected that the negotiations on this matter will be completed during fiscal 1980.

On June 28, 1979, the U.S. Executive Director at the Bank voted with the Directors of other member countries to forward a proposal for increasing the capital to the Board of Governors for their consideration. This vote followed lengthy negotiations throughout the fiscal year. At the time of the vote, the U.S. Executive Director stated that the votes of the Directors did not obligate members to subscribe to any part of the increase and he pointed out that prior congressional action would be required for the vote of the U.S. Governor and for additional U.S. capital subscriptions. He also indicated the administration's plans to propose a full subscription by the United States.

Inter-American Development Bank

During fiscal 1979, the Inter-American Development Bank committed a total of $2,029 million, a 24-percent increase in lending over fiscal 1978. Of this amount, $1,279 million was lent on conventional terms from the capital account; $696 million was lent on concessional terms from the Fund for Special Operations. In addition, the Bank committed $54 million in funds administered for various donors (primarily the Venezuelan trust fund). As of September 30, 1979, cumulative lending by the Bank was $14.7 billion, of which $7.6 billion had been lent from capital, $6.1 billion from the FSO, and $1.1 billion from other resources, primarily the U.S. social progress trust fund and the Venezuelan trust fund.

In terms of sectoral concentration, energy, agriculture, and industry continued to receive during fiscal 1979 the greatest amount of Bank financing. Other sectors receiving substantial amounts of Bank funding included transportation and communications, environmental and public health, education, export financing, preinvestment, and tourism.

IDB lending operations are financed for the most part from borrowings in international capital markets, based on callable capital subscriptions of member countries, as well as from paid-in capital subscriptions and contributions to the FSO. The total subscribed capital of the Bank as of September 30,

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1979, was $11,581 million, of which $1,396 million was paid-in and $10,185 million was callable. The resources of the FSO as of the same date amounted to $5,907 million. The U.S. subscriptions to IDB capital totaled $4,059 million, or approximately 35 percent. Including contributions which were fully authorized, but not completely appropriated, U.S. contributions to the FSO amounted to $3,640 million, or 62 percent of the total resources contributed for concessional purposes.

In fiscal 1979, the Inter-American Development Bank borrowed a total of $413.6 million or its equivalent from the international capital markets. This total included $105.9 million from U.S. capital markets with the remainder coming from capital markets of Western Europe and Japan, including $68.5 million of 1- and 2-year bonds sold to central banks in Latin America and the Caribbean and $4.5 million of 2-year bonds to central banks in nonregional countries. As of September 30, 1979, the Bank's outstanding funded debt amounted to $2,454 million.

During fiscal 1979, the United States and other member countries of the Bank reached agreement on a replenishment of resources to cover the period 1979–82. The terms of this agreement represented substantial progress toward meeting several fundamental U.S. policy goals including: Increasing Bank lending which directly benefits the poor; achieving a more equitable sharing of the burden for providing economic assistance; and placing greater emphasis on conventional lending with consequent reductions of U.S. budgetary outlays because the extensive use of callable capital does not entail annual outlays. During the next 4-year period, one-half of all Bank lending will be devoted to projects which provide benefits directly to low-income groups. In addition, at least 80 percent of convertible FSO resources will be used in the poorest countries of the hemisphere during the second half of the replenishment period and all such resources destined for other recipient countries will directly benefit low-income groups in these countries. As part of the burden-sharing arrangements, nonregional member countries increased their capital contributions by 2½ times and the relatively more advanced countries of the hemisphere such as Argentina, Brazil, and Mexico increased the convertible currency portion of their contributions to the FSO.

At the 1979 annual meeting of the Bank in Montego Bay, Jamaica,[35] the U.S. representative noted the accomplishments of the Bank such as adherence to lending goals, improvement in the rate of disbursement, mobilization of private resources through cofinancing, and increases in efficiency and effectiveness through steps such as the reorganization of the Office of External Review and Evaluation. He also stressed the importance of the Bank's mandate to intensify its efforts to channel resources to projects benefiting low-income groups and to maintain an appropriate balance between structural transformation and growth with equity.

[35] See exhibit 76.

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Asian Development Bank

ADB lending in fiscal 1979 totaled $985 million, compared with $996 million in fiscal 1978. Of the fiscal 1979 loans, $583 million came from Ordinary Capital resources and $402 million from concessional funds. As a result, cumulative lending by the Bank at the end of the U.S. fiscal year stood at $5,730 million—$4,014 million from Ordinary Capital and $1,716 million from concessional resources. In fiscal 1979, as in fiscal 1978, agriculture and agro-industry continued to account for the largest proportion of Bank lending. Other sectors receiving major amounts of Bank financing were power, transportation and communications, and industry. The largest borrowers from the ADB's Ordinary Capital resources in fiscal 1979 were Indonesia, the Philippines, and Korea. The largest borrowers from the ADB's concessional resources were Pakistan and Bangladesh.

ADB Ordinary Capital lending operations are financed by paid-in capital subscriptions, funds borrowed in private capital markets and from governments and central banks, repayments of principal and interest on loans, and net earnings on investments. Asian Development Fund resources—used for concessional loans—derive from member country contributions, amounts set aside from Ordinary Capital earnings, and repayments on loans. As of September 30, 1979, the total subscribed capital stock of the Bank was $8,842 million. Its fiscal 1979 gross borrowings were $222 million, including $70 million in 2-year U.S. dollar bonds. The Bank's outstanding borrowings as of September 30, 1979, amounted to $1,713 million.

In May 1979 at the 12th annual meeting of the Board of Governors in Manila, the U.S. representative reiterated the continuing firm support of the United States for the Asian Development Bank and its programs. He noted the Bank's greatly increased efforts to help expand food production and the particular emphasis it has placed on lending in the agricultural sector as a whole. He also acknowledged the Bank's initiative in helping its developing member countries increase alternative sources of energy and to further develop their mineral resources for energy purposes.

African Development Fund

The African Development Fund (AFDF) was created on July 3, 1973, as the concessional lending affiliate of the African Development Bank (AFDB). The AFDF is designed to channel resources to the poorest African nations; except in the most unusual circumstances, its loans are not extended to countries with a per capita GNP in excess of $400.

The United States joined the AFDF in November 1976 with an initial contribution of $15 million and contributed a further $10 million in December 1977. In 1978, an additional $25 million was made available. In addition to the United States, membership in the AFDF includes 13 European countries, Brazil, Canada, Japan, Kuwait, Saudi Arabia, and the AFDB, which has no nonregional members. Total resources pledged to the fund amounted to $1,147 million as of September 30, 1979.

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In fiscal 1979 AFDF lending amounted to $207.6 million, distributed among 22 African countries. This represented an increase of $52.4 million, or 34 percent, above the 1978 lending level of $155.2 million. Among the largest borrowers were Upper Volta, Somalia, Egypt, and Sierra Leone.

AFDF lending in 1979 was used to finance projects in the agricultural, transportation, and educational and health sectors. Agriculture accounted for the largest proportion of lending, ranging from rural development and extension of farming techniques to development of irrigated farming, rehabilitation of plantations, and infrastructural works. It is expected that this particular pattern of lending will continue inasmuch as the possibilities for improving the living conditions in recipient countries depend importantly on agricultural development. Transportation and education and health represented the sectors receiving the second and third highest amounts of lending, respectively.

The sixth annual meeting of the African Development Fund was held in Abidjan, Ivory Coast, in May 1979. The U.S. representative at this meeting emphasized the deep commitment of the United States to helping African countries solve their difficult economic problems and the policies that have been adopted to further their development. He also welcomed the establishment of new guidelines by the fund which have placed greater emphasis on reaching poor people in recipient countries and on increasing the productivity of small farmers. At the same meeting, the Board of Governors of the African Development Bank approved an amendment to the charter of the Bank which was adopted in 1964 opening Bank membership to nonregional countries. The proposed amendment is now in the process of being ratified by the individual member countries of the Bank.

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ADMINISTRATIVE MANAGEMENT

Management and Organization

The Office of Management and Organization (OMO) advises top officials of the Department and its 11 bureaus on the organizational structures and management systems best suited to carry out their functions. The following are the Office's principal activities during fiscal 1979.

Organizational changes

Office of the Secretary.—OMO assisted in the creation of the Office of Small and Disadvantaged Business Utilization, the function of which is to channel information and advice to small and disadvantaged businesses with regard to Treasury functions and responsibilities, and to promote Treasury contracting with such businesses.

The Deputy Assistant Secretary (International Economic Analysis) and his staff were transferred from the supervision of the Assistant Secretary (Economic Policy) to that of the Assistant Secretary (International Affairs), effective October 1, 1979.

Other changes included the transfer of the departmental paperwork function to OMO, and the Treasury payroll/personnel information system and emergency planning to the Office of Administrative Programs.

Departmental.—OMO participated in the reorganization of two Treasury bureaus. The U.S. Customs Service implemented a headquarters reorganization plan which streamlines the top management structure, reducing the number of assistant commissioners from six to four with better activities grouping. For example, all activities related to importation of goods were grouped under one assistant commissioner.

The Bureau of the Mint reorganized its headquarters, eliminating the Office of the Assistant Director for Administration and redistributing its subordinate components, and abolishing the Public Affairs Staff. Several other offices were renamed and functions realigned.

Special projects

Office of the Secretary.—One of the year's major initiatives undertaken by OMO was the implementation in the Office of the Secretary of the work planning/performance review system developed during fiscal 1978. This system gives managers and supervisors greater flexibility to reward performance, and allows employees to develop their own work goals and performance criteria in conjunction with their supervisors. OMO, with the assistance of a contractor, designed forms and training materials, gave training, administered the pilot program, and evaluated it. The evaluation led to further refinement of the system and its adaptation for evaluating the performance of Senior Executive Service members in fiscal 1980 as required by the Civil Service Reform Act.

OMO also reviewed the alternative work schedules available under the Federal Employees Flexible and Compressed Work Schedule Act of 1979, and prepared an implementation plan for use in the Office of the Secretary. Under the system, employees can choose varied work hours and compressed workweeks, which will allow greater flexibility in individual schedules and fewer commuter trips.

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Departmental.—The Chief of OMO's Management Analysis Division chaired the task force examining allegations of mismanagement and misconduct in the Bureau of Engraving and Printing. The task force presented plans to tighten financial management and procurement practices and contributed to the Under Secretary's testimony on the subject before the Senate Permanent Subcommittee on Investigations.

Senior analysts led the review of operations at the Mint's New York Assay Office which resulted in about a 100-percent increase in the productivity of gold refining.

A senior analyst designed an organization structure and staffing pattern for the newly established Office of the Inspector General and conducted surveys of all bureaus to determine what programs they had in place suitable for implementing the President's effort to reduce waste, fraud, and error in Government operations.

OMO also responded to the need for a study of the quality of integrity investigations conducted by the Bureau of Alcohol, Tobacco and Firearms. The study identified current problems and proposed ways to insure the independence and objectivity of these investigations.

In accordance with its responsibility to oversee the implementation of OMB Circular A-76 concerning the contracting out of commercial and industrial activities, OMO conducted a review of coin bag production at the Philadelphia Mint. The study showed that the Mint could procure the bags from private sector producers at a cost saving.

Continuing management programs

Zero-base budgeting objectives.—During fiscal 1979, all Treasury bureaus submitted ZBB objectives and participated in periodic progress review sessions with their policy supervisors and other policy and staff officials. Key fiscal year operating objectives were defined, expected accomplishments set, and specific milestones identified for tracking during the year.

Advisory committee management.—Operating under procedures whereby the Secretary personally approves the establishment or renewal of all advisory committees, Treasury renewed two committees and established one new one during the year. The new committee, the Foreign Portfolio Investment Survey Advisory Committee, was created to provide views of qualified persons regarding the collection of statistics on portfolio investments by foreigners in the United States and of U.S. citizens' portfolio investments abroad. This was mandated by the International Investment Survey Act of 1976.

Productivity management.—OMO continued to work with the bureaus to improve their productivity programs. During the year the last two bureaus were added to the Federal productivity measurement system. Also, improved measures were identified and productivity measurement coverage was increased in five other bureaus.

Departmental information resources management program.—During fiscal 1979, the Departmental Paperwork Management Office was reorganized and redesignated as the Departmental Information Resources Management Staff.

The major information resources management project was to reduce the public reporting burden. As the result of a concerted effort by all bureaus, but especially IRS, the fiscal 1979 Treasury goal of reducing the public reporting burden by 12 million work hours was exceeded in April. Continuing efforts have further reduced the number of work hours required. Treasury is installing an information locator system for the purpose of eliminating duplicate information requirements while increasing office productivity.

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Formal liaison arrangements were established with the Business Advisory Council on Federal Reporting and the U.S. League of Savings and Loan Associations to obtain input from concerned elements of the private sector before initiating public reporting requirements. Finally, a member of the staff worked on an OMB task force to design better methods for controlling the collection of information from the public.

As part of the continuing program to fully implement the consolidated Treasury Department Directives Manual System, 80 percent of the directives that were formerly part of 17 separate issuance systems have been incorporated into the manual. A new system for numbering and issuing Treasury Department orders was developed.

In response to a court mandate, the staff produced records required by A.T.&T. in its defense of an antitrust suit lodged by the Department of Justice. Although producing the records presented a major logistical problem, the staff met the court requirements in a timely manner.

Other accomplishments included initiatives in managing microform and automating offices, developing new uses for word processing equipment, reducing records holdings at Federal Records Centers, and drafting legislative proposals to reduce statutorily required paperwork.

Assistance to international visitors.—In fiscal 1979, the activity of the International Visitors Program office has increased substantially, providing orientation and specialized consultation and observational programs for visitors from all parts of the world referred by the International Communication Agency and other organizations. The office has arranged appointments for 128 individuals; arranged group meetings for an additional 80 international visitors; held briefings at Treasury for 5 classes of junior Foreign Service officers; and, as a new activity, conducted a special meeting for program officers from the agencies sending visitors to Treasury.

Financial Management

The activities of the Financial Management Division during fiscal 1979 were largely devoted to the daily ongoing requirements of budget, accounting, and payroll liaison operations for the Office of the Secretary.

Treasury payroll/personnel information system

The Treasury payroll/personnel information system (TPPIS) is continuing to improve in its services and products to its users.

One major accomplishment was the implementation of a procedure for teleprocessing a magnetic tape to four regional disbursing offices of the Bureau of Government Financial Operations from where the checks are produced and shipped. Prior to this, all checks were produced in San Francisco.

A major technical endeavor already improving the efficiency of TPPIS relates to the teleprocessing of payroll information between remote terminals. The time and attendance information is entered through remote terminals and transmitted to the central-processing computer in San Francisco. To date, all regional offices and headquarters of the Bureau of Alcohol, Tobacco and Firearms have been converted. Plans have been developed to convert all TPPIS users in early 1980. Keypunch errors and resultant corrections will be eliminated, and since payroll data can be transmitted later in the pay period, most adjustments can be avoided as well as delays in payment of overtime.

TPPIS has begun an independent mode of operation by implementing its own systems modifications to the payroll system, and controlling and

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scheduling the biweekly computer operations previously performed by the Bureau of the Mint. Formerly, TPPIS relied upon the Department of the Interior for the systems changes. This position has been achieved as a result of efforts to provide the General Accounting Office with complete documentation of the TPPIS system. TPPIS is still awaiting final approval by GAO of its formal submission.

Budget and program analysis

The Office of Budget and Program Analysis continued to develop policies and procedures and to direct and coordinate the formulation, justification, and presentation of budget levels which totaled almost $66 billion in fiscal 1979. The amount includes $3.9 billion for operating appropriations, $55.2 billion for public debt and other interest, and miscellaneous accounts, and $6.9 billion for general revenue sharing. In addition, the Office initiates selected analytical studies designed to systematically measure the achievements of bureau programs with stated objectives.

During fiscal 1979, the budget staff—

1. Maintained controls on expenditures, number of personnel on roll, reprogramming activities of each Treasury bureau, and uses of appropriated funds as specified by departmental, OMB, and congressional policy.

2. Gave special budgetary consideration and emphasis, including the preparation of requests for budget amendments, supplemental appropriations, and reimbursements, to programs of special concern to the administration. These included the supplementals for the gold medallion program (Mint) and the anti-cigarette-smuggling program (ATF), the reprogramming for the production of the new Susan B. Anthony dollar coin, and Treasury support of the Council on Wage and Price Stability through employee details from several Treasury bureaus. The annual budget requests reflected major enhancements for the IRS to implement new tax legislation and the Bureau of Government Financial Operations for one-time claims payments totaling over $540 million.

3. Obtained supplemental appropriations for the cost of pay increases authorized by Executive Order 12087, wage board actions, and administrative actions amounting to $84.6 million. A total of $45.4 million of the increased costs was absorbed by application of program savings, reimbursements, and use of budgetary reserves.

4. Issued new instructions for the Treasury Financial Resource Management System (spring budget process) which simplified the requirements and aligned the structure of the submission to agree with the later departmental zero-base budgeting submission.

5. Assisted in the preparation and presentation of budget requests for funds totaling $3.625 billion to be appropriated to the President for the U.S. share to the multilateral development banks, of which the Secretary of the Treasury serves as a Governor.

6. Assisted in the preparation of budget justification material leading to the establishment of the National Consumer Cooperative Bank. The purpose of the new authority is for initial capitalization, as authorized by Public Law 95-351, to make loans and provide services to consumer cooperatives and other types of self-help cooperatives.

7. Undertook a review of administrative travel requirements, requested by the President, which resulted in absolute savings totaling $2.5 million.

8. Worked with OMB and the Treasury bureaus to determine the level of employment reductions required to comply with the Civil Service Reform Act provision calling for employment reductions back to September 30, 1977.

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During fiscal 1979, the program analysis staff conducted the following studies:

1. In-house vs. contractual bullion refining—a cost-benefit comparison based upon decision criteria established by OMB Circular No. A-76.
2. Program evaluations conducted by the Department of the Treasury between January 1, 1977, and June 30, 1978.
3. Federal agency grant award notification effectiveness.
4. Cost-effectiveness of Treasury vehicle use.
5. Contracting feasibility study of three selected activities in the Office of Administrative Programs.
6. Suggested improvements for resource allocation decisionmaking of the Federal Law Enforcement Training Center.
7. Linear programming model of Mint production—an evaluation of the Mint expansion and improvement program.

Internal auditing

The Office of Audit provides leadership and professional assistance to Treasury bureaus on their systems of auditing and administrative accounting. The staff also furnishes audit service directly to the Office of the Secretary and to other organizations upon request, and administers the Department's travel and transportation policies.

A formal review and appraisal was made of the internal auditing activities of the Bureau of Government Financial Operations. The report stressed the need to reevaluate recurring audit assignments, provide additional assurances of the auditors' independence, and reduce the audit coverage of the unfit currency operations when conversion to new equipment is being accomplished at Federal Reserve banks. Comments were also provided on the quality of the staff, which reflected a favorable EEO posture and good planning procedures.

The appraisal of internal auditing at the Bureau of the Mint included field work in two of its four field offices. The report recognized the problems in the backlog of report issuances, audit coverage and scheduling, report presentation, and followup procedures. Positive aspects of the program included the Director's support and involvement in internal audits, implementation of nationwide lateral audits, and strengthening of field supervision.

In March 1979, the Office assumed responsibility for issuing departmental travel and transportation directives, and furnishing Treasury bureaus and offices guidance on interpreting these and other directives. Related responsibilities include reviewing first-class travel in the Department, which must be approved by the Deputy Secretary.

The Office continued to provide assistance in support of TPPIS through the monitoring and development of systems documentation, and issuing a directive for coordinating audits of this important computer application. A plan was developed for auditing the system over a period of years, and audits are being initiated on matters that need prompt attention.

In its continuing role of providing advisory assistance to the bureaus, the Office surveyed the financial system of the Bureau of Engraving and Printing at the request of the Assistant Director (Administration). This effort focused on whether the system was adequately meeting informational and disclosure needs and what measures were needed to simplify the financial closing process. System development efforts were also monitored at the U.S. Customs Service and Office of Revenue Sharing.

An audit of the Federal Law Enforcement Training Center included examination of the 1978 financial statements, the system for controlling

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facility engineering and maintenance jobs, contract administration, and the new payroll system. An audit was also made of the Department's working capital fund for fiscal years 1976–78. Improvements in internal controls over supplies and overtime were instituted as a result of the audit.

The Office prepared the consolidated 1978 summary report to the Secretary on internal auditing in Treasury. This report showed that audits contributed to improved management and better control over the Department's revenue collection, fiscal, revenue sharing, manufacturing, and law enforcement activities. Monetary benefits from the audits totaled $173 million.

The Director participates regularly in the activities of Intergovernmental Audit Forums led by the Comptroller General to provide an orderly approach on improving audits of over 1,000 federally funded programs. Meetings were held regularly with Treasury auditors to help unify the audit system.

Personnel Management

During fiscal 1979, extensive activities were geared toward implementation of the Civil Service Reform Act (CSRA) of 1978, which required reevaluation and revision of numerous policies and procedures in all areas of personnel. One of the most comprehensive and sensitive changes involved establishment of the Senior Executive Service (SES). The Treasury transition to SES was completed smoothly and without disruption. Only five eligible Treasury officials declined to join SES.

As a major step in implementing the CSRA, a unique task force of high-level executives, representing the bureaus, developed overall SES policies for nearly 600 executives. These policies included performance appraisal systems, Performance Review Boards, Executive Resources Boards, and development for and within SES. Other task forces proposed policies for merit pay, general performance appraisal systems, and management development.

A departmental Executive Resources Board, chaired by the Deputy Secretary, with subordinate bureau boards, has been established and charged with implementing and managing the SES in Treasury.

Substantive changes were mandated by the CSRA to the adverse action regulations in Federal personnel management. Formerly, adverse actions such as removals, suspensions over 30 days, etc., could only be proposed and effected for such cause as would promote the efficiency of the service. Adverse actions may still be taken on that basis, but now removals and reductions in grade may also be initiated and effected solely on the basis of an employee's unacceptable performance.

Action was also taken to implement the Federal Employees Part-Time Career Employment Act. As required by the act, proposed regulations were published in the Federal Register for public comment.

The Office worked closely with the Office of the General Counsel in implementation of the financial disclosure provisions of the Ethics in Government Act.

Treasury maintains its lead of all Cabinet agencies in union organization. Sixteen different ones represent just over 103,000 employees in 9 Treasury bureaus and the Office of the Secretary. This represents nearly 84 percent of the Department's total employment.

Treasury's labor relations program is undergoing dramatic changes as a result of the enactment of CSRA. The act provides for the first time a statutory basis for the program. The changes in the program brought on by

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the act will have a significant impact on personnel management. They will expand the trend toward broader and more complex negotiations and will increase the volume of disputes between labor and management requiring third-party resolution. The Federal Labor Relations Authority, created by the act to carry out the purpose of the Federal Labor-Management Relations Statute, has begun to rely heavily on the issuance of major policy statements as a means of interpreting the chapter of the act dealing with labor relations. Agencies have been given the opportunity to provide the Authority with their views prior to its issuance of major policy statements.

The Department's Labor Relations Information Center, designed for research and casehandling informational resource requirements, will become more important to bureaus in preparing for negotiations as well as resolving disputes. The Center permits access to a computerized retrieval system of labor relations agreements and cases.

More than one-third of the outstanding employees recognized by the Secretary at the annual awards ceremony were below the GS-9 level, and more than one-third were women and minorities. This was the broadest representation ever achieved.

The Department initiated a pilot career development/training program for women at all levels in Treasury. Also, the Three-Phase Executive/Management Effectiveness Program was held several times and is resulting in substantial management improvements in participating bureaus.

Administrative Programs

A significant organizational change was the combining of the Emergency Preparedness Staff and the Physical Security Office into the new Emergency Preparedness and Physical Security Division within the Office of Administrative Programs.

Emergency preparedness

The Emergency Preparedness Staff directed primary emphasis to the continuing enhancement of the Department's overall emergency preparedness posture. Improvement was achieved through program review and evaluation, participation in interagency projects, task forces, and civil readiness exercises. It is essential that Treasury's contingency plans be developed in keeping with changing concepts and technologies, and in anticipation of potential crises. To this end, a close working relationship was maintained with the Federal Emergency Management Agency and other departments and agencies with emergency preparedness responsibilities under Executive Orders 11490 and 12148. Participation in major interagency emergency preparedness activities included studies directed by the National Security Council on Continuity of Government and Mobilization Planning and Programming; Cooperative Postwar Recovery Analysis (COPRA); OLYMPIAD II—A Joint Staff Politico-Military Simulation; review/revision of Federal Civil Emergency Actions Guidelist; National Earthquake Hazards Reduction Program; and Civil Readiness Exercises REX-78 (October 1978) and REX-79 (May 1979), involving Treasury emergency executive team cadres. Although considerable effort was spent on preparedness for response to major national emergency situations, contingency plans were made for immediate emergency situations with potential for impact upon Treasury operations from the independent truckers' work stoppage and the petroleum shortage.

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In the spring of 1979, program leadership was enhanced with the promulgation of Treasury Directives Manual Chapter 10-04, Civil Emergency Preparedness Planning, which assigned responsibilities for planning within the Department and raised program oversight to the Deputy Secretary level. Included in the directive is a list of essential functions to be performed by the Office of the Secretary and the Treasury bureaus during the various phases of a national emergency, including nuclear attack upon the United States.

Zero-base budgeting objective activities implemented included effective response to the President's reorganization project, Federal emergency preparedness and response to disasters, and the program promotion and field assistance project. Both projects will carry over into fiscal 1980 with field visits by Treasury and Federal Emergency Management Agency emergency planners to the 10 Federal standard regions.

The Department's standby readiness posture commands continuing attention for keeping current emergency executive team lists and maintenance of the emergency operating facilities, in which the teams would function when the emergency situation dictates. In this regard, the staff has initiated improvement in the emergency electric power supply, improved the facility medical and radiological protection plans, and activated and operated the Treasury emergency operating facility in a 24-hour test with the relocation of an emergency cadre action team.

Physical security

Treasury's representation was accepted on the Interagency Advisory Committee on Security Equipment, which will further Treasury's interest in the exchange of information relating to security equipment. The committee is chaired by the General Services Administration and is represented by 10 other Federal agencies which will assist in the development of specifications, standards, and test requirements for security equipment.

A departmental directive entitled "Screening of Airline Passengers Carrying U.S. Classified Information or Material" was published. This directive implements antihijacking security measures published by the Federal Aviation Administration and sets forth Treasury instructions to personnel who may be carrying classified information. The directive will help maintain the integrity of the screening process and prevent the compromise of classified information.

A series of bomb threat briefings were presented by a representative of the Bureau of Alcohol, Tobacco and Firearms to all Treasury bureaus, concerning the types of threats received and how the threats should be handled.

Procurement management

Total commercial procurements for the Department in fiscal 1979 totaled $386 million, of which $63 million in contracts was awarded to small business firms. This excludes contracts funded by the Saudi Arabian Government. Of the total amount, $300 million was expended through Treasury negotiated and advertised contracts, with the balance being ordered under established General Services Administration and other agency contracts. The expenditures made to minority owned and operated businesses, to the extent identifiable, both through the Small Business Administration's "8(a)" program and other contracts totaled $6.8 million, which is a tripling of minority contracts over fiscal 1977's total of $2 million, in accordance with President Carter's commitment to minority business enterprise.

During fiscal 1979, the negotiation of 34 blanket purchase agreements for use by all Treasury bureaus provided a savings in excess of $96,000 over

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standard unit prices under existing Government contracts. The Department-wide consolidation of Treasury requirements for 738 law enforcement vehicles procured through GSA and in excess of 16 million rounds of small-arms ammunition resulted in a significant dollar savings over separate procurement methods. Compacts, intermediate- and full-size automobiles, and 31 types of ammunition were purchased.

The procurement program staff conducted a training class for over 250 Treasury headquarters and field office personnel on the procedures of minority business contracting. The Department also continued its staff assistance visit program designed to help identify potentials for improvement in Treasury's overall contracting activities. Visits were made to three bureau headquarters and three regional offices.

In support of the U.S. technical cooperation agreement with the Saudi Arabian Government, Treasury contract specialists, using Saudi funds, awarded and administered contracts in excess of $53 million in fiscal 1979. Contracted services and equipment were to provide improvements to several aspects of the Saudi socioeconomic conditions.

Treasury significantly increased its participation in vendor procurement conferences during fiscal 1979. Departmental personnel or bureau personnel designated to be the Department's representatives attended 13 conferences throughout the Nation to provide information to small businesses and minority vendors interested in selling to Treasury.

Property management

During fiscal 1979, Treasury personal property transactions included the reassignment within Treasury of property valued in excess of $900,000. Personal property valued in excess of $9 million, no longer needed by Treasury, was reported to the General Services Administration for transfer to other agencies, donations, or sales auction. Treasury also obtained, without cost, personal property valued at over $20 million from other Federal agencies.

A nationwide study of the Mint's facility needs was launched in April 1978. Each of the Mint's coin-producing facilities generated exhaustive cost-benefit analyses of its coin production capabilities and needed facility improvements, to identify the most feasible alternatives available for meeting anticipated coinage demand by 1985. The Mint's recommendations were forwarded to the Under Secretary on January 30, 1979, and departmental staff reviews have been completed. Two environmental/historic preservation reviews were conducted, resulting in findings of no adverse impact with respect to the Mint's proposals to improve the Denver Mint facility, to improve the Philadelphia Mint facility, and to acquire a portion of the former Frankford Arsenal to be operated as a satellite facility of the Philadelphia Mint. A final decision to proceed with these measures was made by the Under Secretary in September 1979.

Space planning initiatives to consolidate bureau headquarters activities have been severely hampered by the current leasing and tight Washington, D.C., rental market. The abnormal amount of expiring leases, combined with renewal rights not being extended to the Government, causes further fragmentation. Treasury is now in 58 locations in the metropolitan Washington, D.C., area, with the Office of the Secretary occupying 13 of these locations, including 1 storage facility. A study of the long-range headquarters space needs of the Secret Service has been completed. The study has determined that the Service's needs can best be met by incrementally acquiring the space occupied by other Federal tenants at 1800 G Street,

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N.W., where the Service maintains the majority of its headquarters operations.

An additional 1,840 square feet of nonoffice space in the Main Treasury Building has been reclaimed for office use to satisfy increasing space requirements without adding more leased locations, thus avoiding recurring annual space rental charges. This brings the total space reclaimed to approximately 66,000 square feet over a 4-year period.

The Main Treasury repair and improvement program is progressing:

1. Structural repairs to historically significant chimneys and fireplaces have been completed.
2. Construction of the first phase of structural repairs to the basement floors has begun.
3. Construction is well underway on a $2 million project to replace the primary electrical system, and the fire, security, and civil defense alarms. Project completion is scheduled for August 1980.
4. A construction contract for repairs to balustrades and cornices which have deteriorated and become a potential safety hazard was awarded in August 1979. The contract also includes major repairs to the roof.
5. Design work for installation of an emergency generator system is underway with completion scheduled by the end of 1979.
6. Design work on the project for air conditioning renovations, secondary electrical distribution, window repairs, and downspout and rain leader repairs should be completed in the early summer of 1980.

Printing management

In April 1979, the Joint Committee on Printing reorganized the Federal Electronic Printing and Microform Committee and invited Printing Management to join. An organizational meeting followed in May to review objectives and the areas of interest. One main objective is to evaluate all new technology affecting the graphic arts industry, specifically electronic printing systems and alternatives to publishing. An area of interest is to coordinate and standardize within the Federal Government the implementation of new technology to achieve optimum balance in the Federal printing program.

OMB Circular A-76, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," as initially published, included printing plants operated by the Government. During fiscal 1979, the Joint Committee on Printing, at the urging of Treasury and other Government agencies, notified OMB that under title 44, U.S.C. it was granted the authority to establish and control the existence of authorized printing facilities. As a result, OMB Circular A-76 was revised by Transmittal Memorandum No. 4 to cover "printing and binding—where the agency or department is exempted from the provisions of Title 44 of the U.S. Code." This policy change is significant to Printing Management in that Treasury's eight authorized printing plants will continue to be operated under Joint Committee on Printing guidelines rather than having to rejustify their existence periodically to two different regulating bodies, one executive and one legislative.

Treasury's departmental printing plant, after experiencing a peak in workload during the 1975-76 Bicentennial era, has experienced a decline in workload with a commensurate decrease in facilities and personnel. Changing technologies have also contributed to the realignment of the plant which has resulted in the surplusing of seven items of conventional equipment and a decrease of three working capital fund positions.

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The introduction of the Susan B. Anthony dollar coin generated considerable graphics and printing requirements for the Printing Management Division. Substantial quantities of informational as well as promotional material, ranging from simple single-color flyers to other types of printed material utilizing sophisticated graphic design and extensive use of color, were produced by the three branches of Printing Management.

Additional printing requirements were accomplished in conjunction with the introduction of the new series EE and HH savings bonds, as well as promotional material for the yearly savings bonds campaign.

Telecommunications

Treasury automated communications system.—Substantial progress has been made on the contract awarded in August 1977 for the Treasury automated communications system (TACS). The implementation of TACS in fiscal 1980 will round out the Treasury communications capability by providing a modern message processing and dissemination facility which will increase productivity and efficiency.

Treasury Centrex telephone system.—The Treasury Centrex system has been in service for nearly 3 years and now serves Treasury bureaus and 2 other Government agencies with over 17,000 telephone stations. An automated directory and information service is being designed and should be implemented in 1980. The use of the single-line telephone in lieu of the more expensive multiline telephones or call directors is progressing well and is expected to result in significant savings. The new Centrex attendant service has permitted a reduction of seven telephone operators, one-third of the former staff.

Long-distance telephone cost reduction program.—Treasury continued its efforts to reduce long-distance telephone costs in both the Federal telecommunications system (FTS) and commercial calling. In fiscal 1979, Treasury received an FTS rebate of $1.7 million for the Department, and the Office of the Secretary reduced its commercial long-distance bill by $20,000. Efforts will be continued during the coming year to use detailed calling data and FTS off-net restriction capability to hold down long-distance telephone costs.

Paperwork management

Office of the Secretary paperwork management program.—A task force was established to explore more efficient and effective methods of performing manual paperwork flow systems through the use of micrographics.

Records control schedules, specifically tailored to six major offices, were developed and approved. These schedules will permit the orderly, legal disposal of several thousand cubic feet of records resulting in cost savings to the Treasury.

A decentralized filing system with designated file stations throughout the Office of the Secretary has resulted in the release of several hundred square feet of prime office space for other use and the transfer to the Washington National Records Center of semiactive records.

General services

International support.—The Office of General Services planned and coördinated all administrative requirements, as well as related protocol services, for the U.S. delegation attending the IMF/IBRD meetings in Belgrade, Yugoslavia, and for official visits by Treasury to such other countries as China, Japan, the U.S.S.R., Germany, Romania, and the Middle East.

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Environmental programs

Environmental quality.—The Assistant Secretary (Administration) approved environmental assessments concerning the proposed expansion of the Denver Mint and a Frankford Arsenal support facility for the Philadelphia Mint. New departmental procedures for implementing the Council on Environmental Quality's regulations for the National Environmental Policy Act were prepared and published for public review and comment.

Historic preservation.—Treasury continued its participation as a statutory member of the Advisory Council on Historic Preservation. This included review of studies on Federal projects involving historic properties, and representation on Council task forces such as the Economic Policy Group. In addition to completing Treasury historic preservation reviews in connection with the Denver Mint and Frankford Arsenal assessments, cases involving the possible effect of national bank expansions on historic structures were successfully resolved, including determinations of eligibility of properties in the National Register of Historic Places.

Energy conservation.—The administration of the Treasury energy conservation program continues to be strengthened. A driver education program, developed by the Department of Energy with Treasury assistance, was established in four bureaus to reduce gasoline consumption by exposing employees to fuel-efficient driving techniques. A project was also initiated to assist bureaus in developing solar energy applications to conserve fossil-fuel energy. An initial Energy grant of $84,000 was approved for funding a Customs Service photovoltaic energy proposal.

Information services

The Information Services Division was created by a merger of the library with the disclosure unit.

Library.—Automation programs to support internal operations were further developed; planning for computerization of the circulation control system was completed. The addition of the Lockheed Information Systems DIALOG data base service further strengthened the automated reference services offered by the library. To supplement the information resources of the library collection, an expanded micrographics program was initiated.

Disclosure Branch.—The Disclosure Branch administers the Freedom of Information Act and the Privacy Act for the Department. The accomplishments of the Branch include the establishment of a full-time staff and a task force to study the effect of the existing policies and procedures prior to revision of the departmental regulations.

Safety

Office of the Director of Safety.—The evaluation of the progress of the bureau safety action plans has been completed in four bureaus.

The disabling injury frequency rate (number of disabling injuries per million staff-hours worked) improved by 12.7 percent in calendar 1978 over calendar 1977.

Treasury Occupational Safety and Health Council (TOSHC).—The Council sponsored an occupational health seminar held on October 17, 1978, in the Bureau of Engraving and Printing auditorium. Major topics of discussion by guest speakers included "Noise Abatement," "Effects of Stress on Job Efficiency," "Alcohol and Drug Abuse," and "Health Problems of Aging."

In addition to regular bimonthly meetings, the Council held its annual meeting on May 23, 1979, chaired by the Director, Office of Administrative

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Programs. In attendance were the Deputy Secretary, the Assistant Secretary (Administration), heads of bureaus, and members of the top staff.

Treasury Historical Association

During fiscal 1979, the Treasury Historical Association held three membership meetings. The diplomatic reception rooms of the State Department were visited in February. The fall tour to Baltimore included the old customhouse and Fels Point. A slide/lecture on 16th Street architecture by Sue Kohler of the Fine Arts Commission highlighted the annual meeting.

Officers are Charls E. Walker, Chairman of the Board; Robert B. Burrill, President; Christine F. Ligoska, Vice President; Abby L. Gilbert, Secretary; and Arthur D. Kallen, Treasurer. John Benvegar was appointed Executive Secretary. The Association has 335 members.

The Treasury Historical Association was instrumental in convincing Congress to save, restore, and, under the auspices of the National Park Service, open to the public Friendship Hill, the western Pennsylvania home of Albert Gallatin, the fourth and longest termed Secretary of the Treasury. The society honored Quinter Baker, who was responsible for having the appropriate legislation introduced in Congress. The Association marked eight historic rooms and sites in the Main Treasury Building, including the Secretary's office, with bronze plaques; attempted to save the late 17th-century Rhodes Tavern whence the British watched the Treasury burn in 1814; and approved a pilot oral history project which will concentrate on Treasury history since 1920.

BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

The Bureau of Alcohol, Tobacco and Firearms (ATF) regulates the industries and enforces the laws dealing with alcohol, explosives, firearms, and tobacco.

During fiscal 1979, ATF collected $8.1 billion in Federal alcohol and tobacco excise taxes. Investigations of trade practice violations were made to ensure free and open competition in the alcoholic beverage industry. Actions were initiated to increase voluntary compliance with Federal alcohol regulations. The Bureau moved to alert pregnant women that excessive alcohol consumption may cause fetal damage; to increase production of alcohol for use as a fuel additive (gasohol); to update alcohol advertising and trade practice regulations, and implement consumer-oriented wine labeling regulations.

ATF expanded its explosives enforcement program in fiscal 1979. National response teams were formed to respond immediately in major explosives incidents believed caused by bombing or arson. Arrests for arson rose as arson task forces were expanded to 26 major metropolitan areas.

The development of explosives taggants moved ahead. Taggants would provide a method for locating explosives before detonation, and tracing the source of explosives after detonation. Agents continued to close off channels through which firearms move to criminal elements.

The Bureau assumed leadership in fiscal 1979 for a Federal-State program to curb interstate cigarette smuggling. Cigarette smuggling defrauds State

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and local governments of tax revenue and is a multimillion-dollar criminal enterprise. ATF worked in partnership with State and local authorities to arrest smugglers and seize untaxed cigarettes.

Criminal Enforcement

ATF criminal enforcement programs in fiscal 1979 centered on major, complex violations involving firearms, explosives, and contraband articles. Priority was given to assisting State and local governments hampered by limited resources or jurisdictional restraints. ATF made 5,423 referrals of enforcement data to State and local authorities in fiscal 1979.

Investigations initiated in fiscal 1979 involved 16,216 suspects; investigations of 15,121 suspects were completed; 1,569 defendants were forwarded for prosecution; and 1,319 defendants were convicted.

The investigation of explosives crimes remained ATF's number-one enforcement priority. The Bureau also continued to seek out and apprehend violators who traffic in illicit firearms, and placed emphasis on curbing violators who supply firearms to organized crime. ATF also assumed a new mission to suppress interstate traffic in smuggled cigarettes.

Explosives enforcement

A rise in the criminal misuse of explosives in fiscal 1979 led to 2,740 investigations nationwide by ATF. Of this total, 1,046 were bombings, 221 were attempted bombings, and 619 were incidents of arson. ATF developed 3,697 suspects in explosives investigations; 436 defendants were forwarded for prosecution; and 215 were convicted. Explosives, used illegally and improperly, caused 124 deaths, 815 injuries, and $154 million in property damage.

A record of explosives thefts and recoveries was compiled by ATF, through the use of a computerized system. A toll-free telephone number provided direct contact between citizens and ATF field offices. An "Annual Explosives Report," containing detailed data on explosives incidents, was distributed to law enforcement agencies in this country and abroad.

In fiscal 1979, 58,132 pounds of explosives and 90,658 blasting caps were reported stolen. ATF and other law enforcement agencies recovered 75,571 pounds of explosives and 30,330 blasting caps.

Advances in explosives enforcement during fiscal 1979 included the activation of national response teams; the expanded use of arson task forces; improved techniques for preventing explosives theft, and recovering stolen explosives; and increased training of State and local law enforcement officers in explosives safety and identification.

The two national response teams can be rushed to the scene of major arson or bombing cases anywhere in the country within 24 hours. The teams have particular application when explosives incidents exceed response capabilities available at State and local levels. For example, on May 25, 1979, and ATF national response team responded to a request for assistance from Shelby, N.C. The team conducted a crime-scene search following a $5 million fire which took 5 lives and caused 36 injuries. Two suspects were charged with murder, following a joint investigation by ATF and local enforcement officers.

Arson enforcement

ATF pioneered the concept of arson task forces, which now combine the resources of Federal, State, and local arson investigators in 26 metropolitan

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areas. Philadelphia is one of the cities in which a task force reduced the number of arson crimes. The leader of a Philadelphia arson ring was convicted after the task force there completed its investigation. In another Philadelphia case, an arsonist was hired to burn a store insured for more than $1 million. The store owner and eight conspirators received long prison sentences.

ATF entered into an agreement with the Law Enforcement Assistance Administration to develop 18 training courses for State and local officers investigating arson crimes.

Firearms enforcement

Firearms enforcement was directed toward curtailing the flow of firearms to criminal elements. Firearms investigations encompassed 11,840 suspects in fiscal 1979; 619 cases involved organized crime figures; 644 related to illicit international arms traffic; and 974 were investigations of interstate firearms thefts. In fiscal 1979, 1,031 individuals were convicted for violations of Federal firearms laws.

ATF directed significant support to firearms enforcement programs at the State and local levels, in keeping with the congressional mandate of the 1968 Gun Control Act. Some examples of ATF assistance to State and local enforcement agencies follow:

ATF special agents in New York culminated a yearlong undercover investigation into the illegal distribution of firearms and explosives by organized crime figures. The agents, posing as crime figures, purchased machineguns, silencers, sawed-off shotguns, and explosives. They were offered stolen or hijacked goods, stolen securities, and valuable paintings. As a result of ATF efforts, 22 organized crime figures were apprehended.

Agents in New Orleans conducted an investigation of major narcotics violators who traffic illegally in firearms. Information developed by ATF was turned over to local authorities. A joint investigation ensued and resulted in the arrest of four individuals for murder and the seizure of several firearms.

Agents in Florida, working with local authorities, conducted an undercover investigation into the illicit sale of firearms and destructive devices. Three ATF special agents were wounded by the subject of the investigation. During the gunfight, the subject also was wounded. Investigation linked the subject to two unsolved homicides in another State. He was indicted for these murders, for assaulting Federal officers, and for Gun Control Act violations.

Cigarette smuggling

ATF received enforcement responsibility for the Federal contraband cigarette statute, Public Law 95–575, on December 5, 1978. The law enabled ATF to assist State and local authorities in cases involving interstate cigarette violations. It was passed to curtail organized cigarette smuggling activities which defraud State and local governments by evading tobacco excise taxes. ATF's tobacco enforcement program gives emphasis to curbing organized crime.

On December 5, 1978, the Bureau initiated a Cigarette Enforcement School at the Federal Law Enforcement Training Center, Glynco, Ga. Eight schools were conducted and 242 special agents received training. ATF conducted three regional schools for State tobacco tax officials.

ATF conducted a study of the cigarette distribution system, nationwide, for the purpose of recommending a model system which deters tax evasion. Additionally, the ATF laboratory developed techniques to detect counterfeit cigarette tax stamps and assisted State agencies that encounter this problem.

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A computerized cigarette smuggling intelligence base was established to give field agents immediate access to data on suspects. A strategic system was being designed to identify trends and methods of operation for long-range enforcement planning.

ATF received from the Law Enforcement Assistance Administration (LEAA) a $100,000 grant to train State and local officers in detecting and combating cigarette smuggling. LEAA funded a joint ATF/Florida task force to fight cigarette smuggling by organized crime in that high-tax-loss State.

ATF enforcement efforts to deter cigarette smuggling were not fully operational at the beginning of fiscal 1979. Still, the Bureau and State agencies seized more than 34,000 cartons of contraband cigarettes, 16 vehicles, barbiturates, narcotics, and pornography, and made 29 arrests.

Some selected smuggling cases areas follows:

ATF agents and New York authorities seized more than 2,000 cartons of contraband cigarettes and the suspects were identified.

Another case involved cigarettes smuggled from North Carolina to Rhode Island. A suspect was arrested, and ATF and State officers seized 3,187 cartons of contraband cigarettes.

A seizure made by ATF and New York State agents involved contraband cigarettes also transported from North Carolina. Three men were arrested; 2 vehicles and 6,829 cartons of contraband cigarettes were seized.

Alcohol enforcement

In fiscal 1979, this program directed ATF resources toward the apprehension of persons who traffic in illicit alcohol, or violate Federal laws regarding regulation of the legal alcohol industry.

Legal alcohol.—Nine investigations resulted in recommendations for prosecution in fiscal 1979. Reasons for investigation by ATF include attempts by criminals to infiltrate the legal alcohol industry, falsification of records by regulated industry members, and other violations of the Federal Alcohol Administration Act.

Illegal alcohol.—ATF's past efforts to protect the public safety and tax revenue have eliminated production and sales of illicit alcohol in many areas of the country. The volume of illicit liquor was reduced in remaining areas to a level where, in most instances, State and local authorities can control it effectively. This allowed ATF to investigate those liquor cases where geographic and jurisdictional constraints, or possible conspiracy, precluded successful State or local enforcement. In fiscal 1979, a total of 40 illegal distilleries, 50,000 gallons of mash, and 1,500 gallons of nontaxpaid distilled spirits were seized. Forty criminal cases were recommended for prosecution.

Miscellaneous enforcement activities

ATF developed a priority tracking concept for criminal investigation during this fiscal year. Resources were allocated to each investigation based on its priority, and the costs of each investigation were identified. The Bureau began development of criteria to measure crime prevention measures. A management assessment center was activated to develop and select field supervisors.

Thirteen special agents were assigned full-time to strike forces nationwide, in support of the Department of Justice organized crime program.

Demand for polygragh services has shown a sharp increase in recent years. An ATF polygraph program was started in fiscal 1979, and two special agents qualified as polygraph operators.

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ATF processed 2,825 "relief from disability" applications in fiscal 1979. Applications were based on requests by persons prohibited from owning firearms because of felony convictions. Relief applications may be submitted to ATF under a provision of title 18, United States Code.

Regulatory Enforcement

Compliance

To ensure the determination and collection of more than $5.6 billion in alcohol excise taxes, 4,242 revenue protection inspections were conducted at distilleries, breweries, and wineries. Inspectors conducted 3,911 application and 1,828 consumer protection inspections. ATF issued 1,857 original alcohol permits, and amended 3,772 permits. More than 25,800 tax claims, totaling $217 million, were processed. The Bureau audited tax returns for 928 distilleries, 103 breweries, and 782 wineries.

Work began to implement the Distilled Spirits Tax Revision Act of 1979. The law simplified the determination and collection of distilled spirits taxes, and changed ATF's method of supervising operations at distilled spirits plants. A regulatory audit staff was established to verify excise tax collections and provide auditing services to other ATF activities.

Alcohol regulation

Gasohol.—ATF waived many regulatory requirements to speed the approval of experimental distilled spirits plants for alcohol fuel, or gasohol, production. Gasohol is a mixture of about 90 percent gasoline and 10 percent ethyl alcohol. ATF received more than 10,000 inquiries about alcohol fuel production in 1979; over 300 applications were received and approximately 800 applications were approved for experimental distilled spirits plants.

The public and Congress evidenced intense interest in alcohol fuel. It represents a renewable resource with potential for increasing the domestic energy supply. A number of legislative proposals spurred interest in alternate energy sources, including gasohol. Alcohol fuel development was given impetus by the Energy Tax Act of 1978. It granted a tax exemption to motor fuels containing at least 10 percent alcohol produced from sources other than petroleum, natural gas, or coal. Other legislation provided loan guarantees of $60 million for construction of four alcohol fuel plants.

ATF participated in numerous forums to explain Federal regulations governing alcohol fuel production.

Fetal alcohol syndrome.—ATF coordinated a public awareness campaign to educate the public about the relationship between alcohol consumption by pregnant women and birth defects. ATF enlisted the assistance of governmental, industry, medical, educational, and public service organizations as part of the public awareness campaign.

This public education program is being tested as an alternative to possible Government regulation. ATF retained the option to consider a fetal alcohol syndrome warning label on alcoholic beverages if the awareness campaign does not achieve its purpose, or if more precise fetal alcohol syndrome evidence is developed.

Viticultural areas.—ATF accepted the first petitions to establish viticultural areas for wine, in keeping with regulations approved in 1978. Viticultural areas are grape-growing regions which have boundaries based on geographic factors such as soil, rainfall, and temperature.

The name of an approved viticultural area may be cited on labels and in advertising as a wine's appellation or place of origin. A petition to establish a

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viticultural area in Missouri was under consideration at the close of the fiscal year. Petitions from New York, California, and other States are pending.

Ingredient labeling.—Alcoholic beverage labels do not now identify ingredients or additives contained in such products. Food products regulated by the Food and Drug Administration (FDA) generally do list ingredients.

Following consultation with FDA, the Bureau issued a proposal for partial ingredient labeling of alcoholic beverages. The proposed regulations would allow a bottler to list the range of possible essential ingredients and require specific listing of additives remaining in an alcoholic beverage. A lengthy comment period was provided to accommodate interested parties. All comments received were under study at the close of fiscal 1979, and a regulatory analysis of the ingredient labeling issue is being prepared.

Voluntary disclosure.—Since 1976, ATF has encouraged persons and business entities subject to Bureau jurisdiction to disclose voluntarily suspected violations of laws and regulations administered by the Bureau. It has been made clear that such disclosure will be viewed as a mitigating factor in reaching decisions to restore compliance; however, voluntary disclosure would not result in immunity from criminal, civil, or administrative action.

ATF issued an industry circular setting forth Bureau policy on voluntary disclosures, including actions to be taken, verifications of disclosures by ATF, and referrals to other Federal and State agencies.

Several major companies made disclosures, were investigated, or are being investigated. Voluntary disclosure investigations resulted in offers-in-compromise totaling $865,000 from four industry members.

Nationwide investigations.—The Bureau formalized plans early in the fiscal year for nationwide investigations of major industry members believed to have committed illegal marketing practices. The businesses targeted were not industry members who had reported questionable trade practices under the Bureau's ongoing voluntary disclosure policy.

Firearms regulation

Firearms licensee information program.—Each Federal firearms licensee was furnished two publications in 1979 as a part of ATF's regulatory information program. State and local legal requirements for firearms were contained in the publication "State Laws and Published Ordinances—Firearms." Federal requirements were outlined in easy-to-understand language in the pamphlet "Federal Firearms Licensee Information."

The Bureau made available a series of booklets on Federal law and regulations, ATF rulings, curios and relics determinations, questions and answers on Federal regulation of firearms and ammunition, and a poster highlighting eligibility requirements for firearms purchasers. A pamphlet was developed on the application of Federal law to nonlicensed individuals. An exhibit, describing ATF's regulatory role for firearms, appeared at conventions and shows throughout the country.

Explosives program

ATF sponsored the first National Conference on Explosives Control in New Orleans, September 25–27, 1979. It was attended by more than 200 representatives of Federal agencies having jurisdiction in the explosives area, State governments, industry associations, and members of the explosives industry.

The objectives of the conference were to open lines of communication between industry and regulating agencies, define more accurately issues of

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mutual concern, and foster a continuing effort to achieve uniform and meaningful control of explosives.

Tobacco program

The Bureau processed 820 claims for tobacco tax refunds, and conducted 820 revenue protection inspections and 79 application inspections to ensure the collection of more than $2.4 billion in Federal revenue.

Federal tobacco excise taxes are collected by ATF. The Bureau was studying a proposal to speed the transfer of large tobacco excise tax payments to the Federal Treasury. The study envisions instantaneous electronic tax transfers.

Public Law 95-575, prohibiting the possession and transportation of contraband cigarettes, was enacted November 2, 1978. Regulatory and enforcement provisions of the law are carried out by ATF. The law authorized the Secretary of the Treasury to issue regulations requiring persons to record all dispositions of more than 60,000 cigarettes in a single transaction. Proposed regulations to enforce the law were prepared by ATF.

Technical and Scientific Services

Laboratory system

Five ATF laboratories throughout the United States provided analytical services in fiscal 1979 in support of the Bureau's regulatory and criminal enforcement programs.

In the regulatory area, 31,000 items were examined to protect consumers and validate excise tax collections. ATF produced the annual Authentic Spirits Report, used by 45 Federal, State, and local agencies to determine liquor refill violations. A method was developed to distinguish naturally fermented alcohol from synthetic alcohol in beverage products; this is significant for consumer protection. A pilot study of imported alcoholic beverages showed some of these products did not meet domestic standards; an expanded sampling program was planned for fiscal 1980 to protect consumers and eliminate unfair competition with domestic products.

Evidence was examined in firearms, explosives, and cigarette smuggling cases in support of criminal enforcement programs. Laboratories prepared 2,670 exhibits related to firearms cases and 4,172 exhibits for explosives cases. These included gunshot residue analyses, firearms/toolmark comparisons, and explosives material identifications in bombing cases. An ATF laboratory was the first in the country to detect explosives taggants recovered in a bombing case; information derived from the taggant code contributed to the arrest of a suspect in the bombing-homicide. Laboratory specialists developed methods to test the authenticity of tobacco tax stamps and decals which figure in cigarette smuggling investigations.

Technical services

Firearms enforcement officers and analysts supported more than 250 Federal crime investigations during fiscal 1979. Approximately 500 firearms, silencers, and destructive devices were tested. Assistance was provided to manufacturers in classifying and marking newly designed firearms.

The National Firearms Tracing Center conducted about 60,000 firearms traces in fiscal 1979. Firearms were traced to the point of first retail sale to assist Federal, State, and local law enforcement agencies.

ATF acted on more than 14,000 applications involving the manufacture, transfer, importation, and exportation of 126,000 National Firearms Act

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(NFA) weapons. These were controlled weapons which included machine-guns, short-barreled shotguns, and silencers. Approximately 1,100 evidence certifications were prepared for recovered NFA weapons not recorded, as required by law, in the National Firearms Registration and Transfer Record.

In fiscal 1979, ATF acted on 15,200 permits which permitted the importation of 900,000 firearms and 82 million rounds of ammunition into the United States. The Bureau processes all import permit applications for firearms, ammunition, and implements of war.

ATF explosives technicians provided assistance in 2,500 explosives incidents. This included onsite investigative aid, evaluation of explosives and destructive devices, furnishing court testimony, disposing of hazardous materials, explosives training, and participating as members of ATF national response teams.

Data processing

The acquisition of new equipment expanded the Bureau's automatic data processing capabilities in fiscal 1979. Two analytical programs came on-line. The crime analysis system increased investigative intelligence data; the statistical analysis system permitted indepth evaluation of management data. Microfiche formats were prepared for the capital assets property system and the criminal automated reporting system.

Research and Development

In fiscal 1979, new milestones were achieved in the explosives tagging program to curb criminal bombings. Development was keyed to the detection of explosives before detonation, and the identification and tracing of explosives after detonation.

Explosives tagging for identification

Development and field testing demonstrated that identification taggants could be added to explosives during manufacture, and that the taggants could be retrieved after a bomb blast and decoded to identify and trace the explosive. During the year, a series of tests with tagged explosives was performed for the congressional Office of Technology Assessment, which was conducting an independent review of the tagging program for Congress, and was expected to issue a final report on the program in fiscal 1980. Congress requested such evaluation prior to acting on proposed legislation to place identification taggants in some explosive materials.

ATF research indicated it would be feasible to place identification taggants in sporting grade black powder, using customary manufacturing processes. There was no indication that taggants made manufacture more hazardous, or that taggants degraded the performance of black powder used as a propelling charge in antique or replica weapons.

The Bureau began to formulate standards for incorporating identification taggants into smokeless powder. The goal here was to produce quantities of tagged smokeless powder for use in a testing program coordinated with the sporting arms and ammunition manufacturers.

Research and development with identification taggants was extended to include detonators, detonating cord, and cast boosters.

Detection tagging

The detection tagging program, still in the developmental stage, moved forward in fiscal 1979. One goal was to select a "vapor taggant" which could

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be incorporated into explosives and sensed by detection instruments. A practical detection system would fill a critical security need at locations subject to bomb threats. ATF identified five vapor candidates, from hundreds of compounds considered, which met strict standards required for detection taggant material. Three contractors began production of test samples of detection tagging candidates.

Instrumentation to detect vapor taggants was under development. Instruments would analyze air samples taken near search objects—such as people, packages, or suitcases—and generate an alert signal if the taggant was detected.

A successful vapor taggant demonstration took place in May 1979. The taggant was incorporated into simulated explosives placed in luggage. Test instruments at a remote location detected the presence of the vapor escaping from the luggage. ATF cooperated with Canadian officials to determine the air distribution patterns of vapor taggants in aircraft. Other tests were conducted in September in cooperation with the Federal Aviation Administration.

Administration

Management

The ATF budget for fiscal 1979 was $137 million. Firearms and explosives missions accounted for more than two-thirds of the Bureau's expenditures, and reflected continued emphasis on the investigation of violent crimes.

The first phase of a personnel automated staffing system was completed in fiscal 1979. The system, designed to provide comprehensive data on employee positions and which can be integrated with the ATF payroll system, was scheduled for full implementation in November 1979.

A survey of the Bureau's word processing requirements was completed. It forms the basis for a Bureau-wide word processing management system scheduled for implementation in 1980.

Personnel

ATF was assigned 14 Senior Executive Service (SES) positions. The Bureau's executive development program was being revised to implement the new SES system.

The investigations analysis system completed a full year of operation. Under the system, the complexity of criminal investigations was assessed periodically. The reviews helped fix pay grades for special agent positions.

A program was developed to give each employee a statement of projected retirement, health, accident, and death benefits.

Communications

Toll-free telephone service was expanded to State and local law enforcement agencies, and had particular impact in interstate cigarette smuggling cases.

The Communications Center assisted in the apprehension of 538 suspects and 113 stolen firearms. Communications personnel coordinated the installation of a digital transmission line between Washington and San Francisco; this hookup was expected to increase the reliability of computer operations while cutting computer costs.

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Training

In fiscal 1979, the Bureau provided more than 100,000 hours of training to 31,958 State and local enforcement personnel. Training centered on investigative techniques for explosives, firearms, and cigarette smuggling cases.

Approximately 3,200 of the Bureau's 4,000 employees attended training and development courses during the year. Most training was in technical areas, including criminal investigation, regulatory inspection procedures, and data processing.

More than 1,100 special agents were trained at the Federal Law Enforcement Training Center, Glynco, Ga. Courses included new agent training, criminal investigator school, explosives instructor school, and advanced photography. A new course was developed to combat cigarette smuggling. The Bureau continued to conduct courses in advanced agent training, conspiracy, undercover, arson, explosives handling and explosives investigation, and destruction of explosives.

The major emphasis in regulatory enforcement training was to develop auditing skills. The first centralized class in auditing was scheduled for October 1979.

Basic training was provided for 45 inspectors and 4 auditors; 500 supervisors, inspectors, and specialists attended seminars and refresher training courses.

In-house training in other subject areas was provided to 340 employees.

Printing and distribution

The Bureau placed greater reliance on internal resources for printing requirements during fiscal 1979. Outside printing costs were reduced by about $80,000.

Requests for Bureau forms and publications stabilized at a level of 45,000 per year. Approximately 120,000 reports, industry circulars, and bulletins were mailed to industry members, the news media, and the general public.

Protective programs

A memorandum of understanding was renegotiated between the Departments of Treasury and Agriculture. Under this agreement, in a national emergency, ATF would assume the emergency preparedness functions of the Agricultural Stabilization and Conservation Service, as they related to food facilities producing and distributing alcohol.

An explosives safety program was initiated for Regulatory Enforcement inspectors. A facilities inspection program began in response to increasing emphasis on physical security in ATF facilities. All Bureau offices will undergo security reviews over a 5-year period.

Chief Counsel

Chief Counsel worked with Bureau officials in preparing proposed regulations to implement the new contraband cigarette law. Enacted in fiscal 1979, the law was designed to eliminate large-scale, interstate smuggling of cigarettes to evade State and local taxes. The office assisted in drafting proposed regulations for partial ingredient labeling of alcoholic beverages. This was a joint effort with the Food and Drug Administration. Staff attorneys participated in Bureau studies examining provisions of the Federal Alcohol Administration Act relating to advertising, trade practices, permits, and penalties, and helped formulate program goals for firearms and explosives.

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Legislation and an administrative action plan were prepared and submitted to Congress facilitating increased production of distilled spirits for use as a fuel additive (gasohol).

ATF attorneys assisted congressional staff members in preparing the Distilled Spirits Tax Revision Act of 1979, which became part of the Trade Agreements Act of 1979 enacted during fiscal 1979. They also drafted legislation providing for the use of identification and detection taggants in some explosive materials, and participated in preparation of the Anti-Arson Act of 1979.

Inspection

Twelve internal audits were conducted in fiscal 1979. The audits provided an independent evaluation of ATF operations, saved more than $205,000, and led to improvements in Bureau programs.

Allegations concerning employee conduct caused 113 integrity investigations to be started during the fiscal year. A total of 149 integrity investigations were completed and produced 4 resignations, 19 adverse actions, 10 clearances, and 3 referrals to other law enforcement agencies. Seventy integrity investigations were underway at the close of fiscal 1979.

New-employee background investigations, and security updates, totaled 623. During the year, 519 security investigations were completed; 233 investigations were underway as fiscal 1980 began.

Seven equal employment opportunity complaints were investigated.

Work was underway at the end of the fiscal year to restructure the Office of Inspection as the Office of Internal Affairs. This reorganization responded to an evolution in ATF programs, workload, and organizational structure.

Equal Opportunity

Equal opportunity goals and programs were stressed in fiscal 1979. Positions held by women rose to 32 percent of Bureau positions; those held by other minorities increased to 11 percent of the ATF work force.

In the regulatory inspector job series, 230 of 938 positions are now held by women. Blacks and other minorities occupy 29 percent of these positions. In the special agent series, 114 of 1,601 agents are women and other minorities.

Work force profiles were evaluated regularly on a national basis, with an aim toward further increases among women and minorites. Equal opportunity training programs were carried out in all regions and included specific career development actions. Community outreach activities helped familiarize the public with ATF, its missions, and occupational needs.

Positions were expanded for students attaining degrees under cooperative educational programs. The bilingual hiring program was continued and new recruitment drives were conducted in Hispanic communities.

Public Affairs

Information about ATF was supplied to the public, news media, law enforcement community, regulated industries, and other Government agencies. More than 90 news releases, factsheets, brochures, articles, and speeches were released. Information officers answered some 2,100 individual requests for data on the Bureau and its missions.

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Congressional Affairs

The Office of Congressional Affairs was formed in June 1979, separating it from the Office of Public Affairs.

The Bureau responded to approximately 1,900 written inquiries from the Congress in fiscal 1979. Telephone inquiries averaged 300 per month. Testimony was prepared for nine congressional hearings.

Disclosure

ATF responded to a 20-percent increase in Freedom of Information Act requests and a 47-percent increase in Privacy Act requests during fiscal 1979.

Freedom of Information Act requests numbered 655, of which 472 requests were granted in full, 156 were granted in part, and 27 were denied. Fees collected for Freedom of Information Act requests totaled $13,200.

Privacy Act requests numbered 597, of which 586 were initial requests for access to records; 7 were requests to amend records and 4 were requests for an administrative appeal to the Director. Eighty-three percent of the initial requests were granted—308 in full, 178 in part. Ten percent of the requests were denied.

A primary purpose of the Privacy Act is to assure accuracy in the collection of data about individuals. Five of seven requests to amend records were granted, two were denied. Statistics indicated 98.9 percent of all requesters granted access to their records did not question the accuracy of such records.

Ninety-five percent of all disclosure requests were answered within deadlines set by Federal regulation.

Six civil actions were filed against ATF under the Freedom of Information Act and the Privacy Act.

OFFICE OF THE COMPTROLLER OF THE CURRENCY[1]

The Office of the Comptroller of the Currency was established in 1863 by the National Currency Act, redesignated in 1864 as the National Bank Act (12 U.S.C. 38). The Comptroller, as Administrator of National Banks, is charged with regulating and supervising the national banking system, within the scope of existing statutes and in such a manner as to best serve the public interest.

Operations of the national banking system reflected continued growth of the U.S. economy as a whole through most of 1978, although at a slower pace than in 1977. Total assets of the country's 4,564 national banks increased by 12 percent between yearend 1977 and yearend 1978. Asset growth for the previous year was 11.7 percent for 4,655 national banks.

The total number of national banks declined for the third consecutive year. At yearend 1978, there were 91 fewer national banks than at yearend 1977, although the total number of national bank offices increased by 286 during the

[1]Additional information is contained in the separate Annual Report of the Comptroller of the Currency.

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year. A principal reason for the reduction in the number of national banks continues to be costs associated with membership in the Federal Reserve System.

Bank examinations and related activities

The Office is responsible for examining all national banks. With the ever-increasing demands placed on the Office's limited resources, it has established a national policy on the frequency of onsite examinations. This policy combines onsite examination priorities with an offsite examination program, utilizing National Bank Surveillance System analysis.

Banks requiring special supervisory attention will receive onsite examinations at least twice annually, including at least one full-scope general examination. Banks not requiring special supervisory attention, which have assets of more than $100 million, will receive one onsite examination at least annually. Banks with less than $100 million in assets that do not require special supervision will receive one onsite examination at least every 18 months.

During the year ended December 31, 1978, the Office examined 3,432 banks, 1,040 trust departments, and 45 affiliates and subsidiaries and conducted 75 special supervisory examinations.

Examinations of national banks are meant to provide an objective evaluation of a bank's soundness, to permit the Office to appraise the quality of management and directors, and to identify areas where corrective action might be required to strengthen the bank, improve the quality of its performance, and enable it to comply with applicable laws, rules, and regulations. To accomplish those objectives, the Office employs standardized examination procedures. Because banks are not identical, examiners, drawing on professional judgment and experience, may have to modify the application of those procedures to fit the circumstances encountered in each bank. The use of such procedures provides for the conduct of consistent and objective examinations of varying scope.

As of December 31, 1978, the Office employed 2,254 examiners—2,093 commercial and 161 trust. Included in these numbers are examiners specifically trained in computer operations and consumer affairs and regulation. These specialized areas are a part of the regular examination process.

International banking issues which confronted the Office during the year included the growth in national banks' foreign assets, deposits, and earnings; foreign exchange activities; their substantial lending to foreign public sector borrowers; and the problem of the applicability of statutory lending limits to such credits.

Cooperation among three Federal bank regulatory agencies marked the activities of the International Examinations Division. During 1978, the three bank regulatory agencies adopted uniform procedures for evaluating and commenting on "country risk" factors in international lending by U.S. banks and further refined the joint, semiannual Consolidated Country Exposure Reports which show, by country, the foreign claims held by U.S. banks and bank holding companies.

Customer and community programs

In the 1978–1979 reorganization of the Office, consumer affairs activities were expanded and restructured into three divisions headed by the Deputy Comptroller for Customer and Community Programs.

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The Consumer, Community and Fair Lending Examinations Division is responsible for all examination-related activities in the areas of consumer protection, community lending, and civil rights. The Customer Programs Division, established in 1978 but not fully operational, will develop and implement consumer and civil rights programs outside of the examination process. The third division, the Community Development Division, parallels the Customer Programs Division and concentrates on community lending. In addition, a position of Special Assistant for Civil Rights has been created to oversee Office efforts to comply with the terms of the fair housing suit settlement, to initiate policies and programs to strengthen the Office's enforcement of civil rights, and to provide liaison with civil rights organizations.

In 1978, approximately 300 consumer examiners participated in Office training schools. Also participating were representatives from trade associations, consumer groups, and other Federal and State regulatory agencies. A consumer career path has been developed which will allow examiners to remain in the consumer examination program and advance in salary and position up to Regional Director of Customer and Community Programs.

Administration

The Administration Department is responsible for providing a range of administrative services which support the ongoing functions of the Office. The Department is divided into five operating divisions—Equal Employment Opportunity, Finance and Administration, Human Resources, Operations Planning, and Systems and Data Processing.

An indepth analysis of the Office work force was conducted in January 1978 to identify areas where underrepresentation of minorities and women exist. This assisted Office officials in setting hiring projections and promotion goals in those areas.

The Financial Management Branch further refined the computer-based financial information system which relies on the concept of cost center responsibility accounting. The system provided managers with timely financial information to use in analyzing and controlling the costs of their operations.

The Human Resources Division continued the successful implementation of the human resources programs approved by the Department of the Treasury in January 1977. Major accomplishments were made in the areas of personnel development, compensation, staff analysis, national recruitment, employee relations, and staffing and operations.

Working with a newly established planning/budget integration committee, the operations planning staff revised the planning process to include budgeting which, for the first time, permitted managers to address Office operations both functionally and organizationally.

During 1978, national bank call reports were successfully processed and NBSS bank performance reports were provided on time to all Office regions and national banks during the four quarters of 1978. Bank performance reports were also produced for the Federal Reserve System and, during the last two quarters of 1978, for State banks in New York and Virginia.

Law Department

The Law Department, under the direction of the Chief Counsel, advises the Comptroller and his staff on legal matters arising in the administration of laws and regulations governing the national banking system. Attorneys in the Law Department deal directly with the management of national banks, with bank

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attorneys and accountants, and with the staffs of other Government agencies and congressional committees. The Department also participates in litigation involving the Office and exercises certain direct responsibility in enforcement and securities matters.

At the beginning of 1978, 55 lawsuits were pending involving the Office. During the year, 45 new lawsuits were filed and 30 cases were closed. For the second consecutive year, the number of formal administrative actions under the Financial Institutions Supervisory Act processed by the Enforcement and Compliance Division increased 50 percent over the preceding year. The Securities Disclosure Division reviewed the activities of the 340 national banks which have a class of securities registered pursuant to the Securities Exchange Act of 1934. The Legal Advisory Services Division processed 1,900 formal written inquiries during the year.

OFFICE OF COMPUTER SCIENCE

The Office of Computer Science is the focal point for information systems technology in the Department. The Office has central management responsibilities for planning, policy, and evaluation in information technology throughout the Department. Also, it furnishes computer processing and systems development services to the analytical, policy formulation, and administrative functions of the Office of the Secretary.

A new interim Univac 1100/81 computer system was installed in the Computer Center this year. It provides the greater capacity needed and solves reliability problems which have plagued users in recent years. This equipment will meet known requirements for about 18 months. The Center now serves 40 organizations concentrating on econometric analyses and administrative processing.

During fiscal 1979, a request for proposal was released to upgrade the present computer system through a fully competitive procurement. This will meet most Office of the Secretary computer requirements through 1986.

A new economic analysis language tool was made available to users in the Office of the Secretary during this year. This software permits economists to perform a wide range of activities ranging from simple arithmetic to highly advanced economic model development and solution. It provides a cost-effective alternative to some of the econometric analysis work currently performed. In addition, a comprehensive economic data base has been established to operate with the new language. This data base contains approximately 25,000 economic time series covering the national income products accounts, Federal Reserve flow of funds, employment, earnings, labor force statistics, and international economic data. It is intended to ultimately include all data elements of common interest to Treasury economists.

Correspondence tracking systems were implemented in the Office of the Secretary for the Executive Secretariat, the Assistant Secretary (Legislative Affairs), Assistant Secretary (Tax Policy), and the Assistant Secretary (Public Affairs). The systems provide a network in the Office of the Secretary so that correspondence and legislation can be tracked across offices.

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A consolidated financial system for the Financial Management Division was further developed. This effort consists of the development and implementation of a fully integrated financial system which includes both obligation and general ledger accounting. These systems will provide accounting for both current and prior fiscal years. The funds supported by the accounting system are the Office of the Secretary salaries and expenses, Office of Revenue Sharing funds, the Office of the Secretary working capital fund, New York City fund, and the Exchange Stabilization Fund.

OFFICE OF DIRECTOR OF PRACTICE

The Office of Director of Practice is part of the Office of the Secretary of the Treasury and is under the immediate supervision of the General Counsel. Pursuant to the provisions of 31 CFR, part 10 (Treasury Department Circular No. 230) and the provisions of 31 CFR, part 8, the Director of Practice institutes and provides for the conduct of disciplinary proceedings against attorneys, certified public accountants, enrolled agents, enrolled practitioners, and other individuals who are alleged to have violated the rules and regulations governing practice before the Internal Revenue Service or the Bureau of Alcohol, Tobacco and Firearms. He also acts on appeals from decisions of the Commissioner of Internal Revenue denying applications for enrollment to practice before the IRS made under 31 CFR, section 10.4, and appeals from decisions of the Director, Bureau of Alcohol, Tobacco and Firearms denying applications for enrollment to practice before ATF made under 31 CFR, section 8.21. The Director of Practice also serves as Executive Director of the Joint Board for the Enrollment of Actuaries. The Joint Board, formed pursuant to section 3041 of the Employee Retirement Income Security Act of 1974 (ERISA), is responsible for the enrollment of individuals who wish to perform actuarial services under the act and for the suspension and revocation of the enrollment of such individuals after notice and opportunity for hearing.

On October 1, 1978, there were 177 derogatory information cases pending in the Office under active review and evaluation, 12 of which were awaiting presentation to or decision by an administrative law judge. During the fiscal year, 104 cases were added to the case inventory of the Office. Disciplinary actions were taken in 67 cases by the Office or by order of an administrative law judge. Those actions were comprised of 7 orders of disbarment, 40 suspensions (either by order of an administrative law judge or consent of the practitioner), and 20 reprimands. The actions affected 20 attorneys, 37 certified public accountants, and 10 enrolled agents. Fifty-seven cases were removed from the Office case inventory during fiscal 1979 after review and evaluation showed that the allegations of misconduct did not state sufficient grounds to maintain disciplinary proceedings under 31 CFR, part 10 or under 31 CFR, part 8. As of September 30, 1979, there were 157 derogatory information cases under consideration in the Office.

During the fiscal year, 18 attorneys, certified public accountants, and enrolled agents under suspension or disbarment from practice before the IRS petitioned the Director of Practice for reinstatement of their eligibility to resume practice. Favorable disposition was made on 15 of those petitions and

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reinstatement was granted. One petition was denied. Two petitions remained pending at the year's end. In addition, the Director of Practice granted the two petitions pending from the previous year. There were two appeals from denials by the Commissioner of Internal Revenue of applications for enrollment to practice before the IRS. One decision reversed the denial, and one appeal sustained the denial. There were 20 appeals pending from the previous fiscal year. All these denials were reversed by the decision on appeal.

Twenty-one administrative proceedings for disbarment or suspension were initiated against practitioners before the IRS during fiscal 1979. Together with the 12 cases remaining on the administrative law judge docket on October 1, 1978, 33 cases were before the administrative law judge during the year. Seven of those cases resulted in the acceptance of an offer of consent to voluntary suspension from practice before the IRS pursuant to 31 CFR, section 10.55(b) prior to reaching hearing. Initial decisions imposing disbarment were rendered in seven of the cases; initial decisions imposing suspension were rendered in three cases. On September 30, 1979, 16 cases were pending on the docket awaiting presentation to or decision by an administrative law judge.

During fiscal 1979, three cases were appealed to the Secretary from the initial decision by an administrative law judge. One case resulted in an affirmation of the administrative law judge's order of disbarment; the other two appeals remained pending at the year's close. In addition, one decision was issued by the Secretary on an appeal from the initial decision of an administrative law judge pending October 1, 1978. In that appeal, the administrative law judge's order of disbarment was affirmed.

During fiscal 1979, amendments to the provisions of Circular 230 governing solicitation and advertising were promulgated. The final rule, which appeared in 44 F. R. 17, January 24, 1979, permitted the expansion of advertising and solicitation by IRS practitioners. Similarly, amendments to the regulations governing practice before ATF were promulgated to permit expansion of advertising and solicitation by those practitioners consistent with the January 24, 1979, amendments to the regulations governing practice before the IRS. The final rule was published in 44 F. R. 156, August 10, 1979. In addition, Circular 230 was amended by final rule published in 44 F. R. 17, January 24, 1979, permitting individuals enrolled to perform actuarial services under ERISA to engage in limited practice before the IRS.

During the year, this Office represented the Department in two employee appeals from adverse actions taken against them by bureaus of the Department.

Twenty-six meetings of the Joint Board for the Enrollment of Actuaries were held during the fiscal year. There were six applications pending under the regulations governing enrollment by the Joint Board before January 1, 1976. Of these applications, two applicants were enrolled and four were denied enrollment. On October 1, 1978, there were 64 applications pending under the regulations governing enrollment on or after January 1, 1976, and 190 applications were filed during the year. Of these, 158 applicants were enrolled and 6 applicants were denied enrollment. Ninety applications were pending at the close of the fiscal year.

During the fiscal year, there were nine derogatory information cases before the Joint Board. After review and evaluation of the cases, the Executive Director issued reprimands to two enrolled actuaries. Seven cases were pending at the close of the fiscal year.

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To assist the Joint Board in the performance of the examination duties imposed on it by ERISA, an Advisory Committee was established on Joint Board Examinations under the Federal Advisory Committee Act. Six meetings of the Committee were held during the fiscal year.

BUREAU OF ENGRAVING AND PRINTING

The Bureau of Engraving and Printing, the world's largest securities manufacturing establishment, designs and produces the major evidences of a financial character issued by the United States. It is responsible for the production of U.S. currency, postage stamps, public debt securities, and miscellaneous financial and security documents.

Finances

The operations of the Bureau of Engraving and Printing have been financed by means of a revolving fund since July 1, 1951, established pursuant to Public Law 656, August 4, 1950 (31 U.S.C. 181), as amended by Public Law 95–81, July 31, 1977. The recent amendment authorized the Bureau to include in the charge for its products an amount to be accumulated for the acquisition or replacement of capital equipment and to provide for future working capital. Agencies which the Bureau serves are required to make reimbursement for all costs incidental to the performance of work or services requisitioned.

Congress has supplied appropriations as increases to the fund on three occasions since the inception of the revolving fund. The donated portion of the revolving fund is $14,250,000. The Bureau financed a program at a total cost of $135 million in fiscal 1979, as compared with $132,407,383 in fiscal 1978 by means of this fund.

Implementation of a resource management concept

The Bureau will operate under a highly decentralized management system, commencing with fiscal 1980, designed to provide individual managers with maximum authority and control over all key Bureau resources and programs. Twenty-two such elements have been identified and assigned, which includes every aspect of Bureau management. Individual resource management plans have been reviewed, amended, and approved by the Executive Management Committee composed of senior Bureau management. All plans are designed to contribute to the overall objective set by the Director, to provide fiscal 1980 products and services at the same cost levels as those provided in fiscal 1979. Regular participative reviews of progress will be made monthly for major programs and quarterly for other resources to provide opportunities for adjustment to major programs. The results of individual managerial efforts will be a basis for incentive awards.

Currency program

Deliveries of currency in fiscal 1979 totaled 3.9 billion notes, as compared with 3.3 billion notes in fiscal 1978.

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The Bureau has reviewed customer demands for the next 5 years. A plan has been devised to acquire new production equipment to replace old equipment and meet increasing customer requirements. The plan awaits departmental and OMB approval.

An extensive effort is being made to develop equipment for electronic examination of currency. The development of an electronic examining machine prototype is now under contract for expected delivery in the latter part of 1980.

Magna press modifications planned at the time of contract settlement have been designed and will be implemented by the close of fiscal 1980. These changes will require extensive advanced scheduling to coincide with an increased demand on already existing heavy currency production schedules.

Manual steel banding and wrapping equipment has been supplanted by two new fully automatic currency banding and wrapping units that will decrease manual intervention and speed the process.

A newly developed mechanical detissuing machine has replaced the slow and labor-intensive manual detissuing operation in the Securities Examining Unit, resulting in faster turnaround time and increased productivity. An estimated annual savings of $16,000 is expected.

The plan to abolish the Currency Receipt and Consolidation Unit was accomplished by consolidation and integration into the currency sheet examining function. Seventeen employees affected either have retired or have been reassigned to other operational needs. Annual recurring savings are estimated at $186,000.

As a result of improved work station design and cooperation between management and labor, bookbinder productivity in the Trimming-Splitting Section was increased by 14 percent, from a standard of 36,000 to 41,000 sheets per person per day. The recurring annual savings to the currency program is approximately $70,000.

Postage stamp program

Deliveries of U.S. postage stamps were 27.1 billion units in fiscal 1979, as compared with 28.5 billion units in fiscal 1978.

Significant improvements in the control of functional characteristics of postage stamps have resulted in a reduction in consumer complaints. Historically, problems with phosphor, adhesive, and perforations were of concern to the general public and the U.S. Postal Service.

A task force was established to monitor the base manufacturing cost of commemorative postage stamps. By prioritizing printing and processing objectives and coordinating applicable resources, the Bureau was successful in reducing product billing rates in spite of inflationary spirals and rising material costs.

An innovative technique resulting from an employee suggestion permitted the examination of postage stamps in-line on the automatic booklet-forming machines. Although cost benefits were nominal, the technique increased machine availability to examine coil stamps backlogged from the 1978 postal rate increase.

For the first time in recent history, the Bureau supplied the U.S. Postal Service with hand-torn or manually separated plate blocks of higher denomination postage stamps of regular issue. Finished select quality plate blocks were processed and shipped to the city of first-day sale and post offices throughout the country. While cost savings were not realized by the Bureau, the Postal Service benefited in terms of efficient window transactions and improved accountability.

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Future plans for postage stamp production were reviewed with completion of solicitations and commitment of funds for one web postage stamp press during the first quarter of fiscal 1980, and a possible option for an additional press in fiscal 1981.

Public debt securities

As indicated by the Bureau of the Public Debt, the tentative schedule for conversion to the book-entry system will result in the discontinuation of printing and processing of Treasury bonds and notes by the Bureau of Engraving and Printing early in 1983.

Food coupon program

The Bureau concluded responsibility for administering contracts for the production of food coupons for the Department of Agriculture with the completion of the fiscal 1979 contract. Future involvement by the Bureau will be limited to affording requested technical assistance to the Department of Agriculture commencing in fiscal 1980.

Gasoline rationing program

The Bureau is pursuing a plan which will provide an emergency production capacity for gas rationing coupons without interruption to the currency supply, pursuant to legislation granting the President standby authority to order the rationing of gasoline. The basics of the plan have been approved by the Under Secretary and Deputy Secretary of the Treasury, and the Secretary of Energy, and have been submitted to the White House. Currently, the Bureau is completing equipment requirements specifications and is in the process of obtaining approval of a coupon design model. If rationing were ordered, the Bureau could activate the plan upon authorization within 45 days.

Forensic science research and development

Continuing cooperative efforts with Natick Army Research and Development Command (NARADCOM) have resulted in the development of new types of distinctive red and blue fibers used in the manufacture of currency paper. Since November 1978, sufficient quantities have been produced by NARADCOM for use. In addition to a research and development contract for fiscal 1980, discussions are proceeding to provide for materials inclusion in the fibers to afford general public recognition.

Action has been initiated, with planned continuity, to counter anticipated developments in the reprographic fields such as color copiers and improved photographic films. Research and development recommendations for technical countermeasures to be taken have been made by the Working Group and Steering Committee comprised of members representing the Federal Reserve Board, Bureau of Engraving and Printing, U.S. Secret Service, Bank of Canada, and Bank of England.

A restructuring of the organization and mission of the research organization is planned to include, in addition to the present counterfeit analysis effort, a document deterrence program for implementing an ongoing technical evaluation program in threats and deterrent strategies related to deterrence of counterfeiting. This component would actively pursue research in reprographics, electro/mechanical computer imaging, substrates, inks, photography, and optics. Expertise will be maintained for implementation of future deterrent efforts both nationally and internationally.

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Inks

To facilitate the use of commercially available material and for environmental considerations, extensive ink development research is currently in progress. This involves development of inks which can be formulated from commercially available material, control of the ink-manufacturing process to a measurable standard, and disposal of the residual material in an environmentally acceptable manner. Intense materials research programs and organizational changes are projected to significantly improve the quality and environmental acceptability of ink products for security documents.

Continuing development of an acceptable roller-wipe (water-wipe) intaglio green currency ink has resulted in prototypes which have achieved an estimated 90-percent success level. Additional press trials and formulation refinement are expected to assure suitable inks for application on present and planned printing press acquisitions. Development of a suitable black intaglio currency ink is underway and significant progress has been made.

A new paper-wipe black intaglio currency ink, formulated to ease manufacturing difficulties and eliminate troublesome raw materials, has become a production reality. This should lead to a phaseout of the traditional formulation in use over many years. A cost-benefit analysis is in progress.

Efforts are being made to convert rotogravure purchased finished inks to an ink base system. This may permit the establishment of base ink specifications on a bid basis, thus eliminating the necessity for rotational procurements of finished inks, especially specialized color-matched inks required for a number of commemorative postage stamps.

The Bureau has successfully developed water-based rotogravure inks devoid of solvents. These inks have been used on a limited number of rotogravure postage stamp issues. The goal is to convert all solvent gravure inks to water base and, if successful, this will ameliorate developing constraints related to the environment, including fire hazards, atmospheric pollution, and workplace exposure to solvents.

Research to identify basic causes of setoff of freshly printed green currency backs from one sheet to another in the intaglio press stacking delivery indicates the cause to be associated with agglomerates of a particular formula component. Differences in the depth of engravings on the different denomination currency notes also appear to influence the amount of setoff, serving to amplify the problem rather than cause it. Reformulation efforts are underway and success in this area can serve to reduce spoilage due to setoff and thus reduce costs.

Quality control

A centralized quality information system has been implemented to provide rapid data feedback to operating elements. The system includes reporting detailed quality data by product, process, and press, and comprehensive investigations of excessive spoilage.

A quality resource management concept has been initiated. This concept gathers and coordinates all quality and inspection functions under a single resource manager. When fully implemented, the concept will provide direct control of all quality characteristics from the procurement of raw materials, through the manufacturing and processing stages, and ending with final products delivered to Bureau customers.

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Accountability

Improved accountability equipment has been designed for all production processes. This equipment will allow for more exact accountability during production and provide immediate feedback of information through microprocessor technology.

Internal audit program

An intensive program of internal audit provides for the evaluation and reexamination of operational and financial efficiency, economy, and internal control, as well as audit reviews of financial accounts and reports; and ensures compliance with prescribed statutory and regulatory directives. During fiscal 1979, 54 reports of audit were released that contained 280 recommendations referred for management consideration. Coverage included fiscal and management-type audits and reviews of operations and programs conducted on a scheduled, special, and unannounced basis. Liaison is maintained with the departmental Office of Audit and the General Accounting Office.

Security program

The security access control system, partially implemented during the previous fiscal year, replaced the pass-badge system and provides for enhanced overall physical security control. Card-actuated security barriers were installed for selected internal operational and securities processing areas, eliminating the time-consuming system of handwritten logs for documenting the personnel movement in sensitive areas.

Executive/management development program

The executive/management development program was developed in accordance with Civil Service Reform Act mandates and Department of the Treasury directives. The policy specifies the roles and responsibilities of the Bureau Director, the Executive Resource Board, program mentors, and Senior Executive Service participants with regard to executive and management selection, placement, and development. It includes methods for providing program participants with the skills, knowledges, and abilities necessary to move into executive and managerial positions. The program is viewed as an important component toward improving the efficiency and effectiveness of Bureau operations and accomplishing mission objectives.

During fiscal 1979, five candidates were selected into the high potential management cadre as "assistant to" positions, and an individual development planning process was designed to provide project assignments and training to develop managerial skills.

Training resource management system

A total system was designed to identify training needs, including budgetary requirements, for monitoring training and related expenses by organizational component. The system enhances capability for affording cost-effective training to meet the specific needs identified during the performance evaluation process.

Technical skills training

Technical training was afforded for plate printer intermediates on the operation of sheet-fed presses. A similar program is being developed for training on web-fed presses. Training methods include video tapes and slides

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explaining the complex mechanisms of the Bureau's currency and postage stamp presses.

CADE (upward mobility)

The CADE policy and promotion plan was revised during fiscal 1979. Three participants graduated from the program and six others are currently in trainee positions. Emphasis has been placed on improving and counseling skills of the CADE staff and increasing counseling opportunities for the CADE population.

Cooperative education

The Bureau initiated a cooperative education program with the Rochester and West Virginia Institutes of Technology in printing management early in 1977. Since then, two employees have been enrolled in cooperative education work assignments, and one has completed the 1,040 work-hour experience and graduated from the program. The program, recently expanded to include the University of the District of Columbia, provides an opportunity to assess the performance of potential candidates who have educational backgrounds in printing management.

Labor-management relations

A series of labor relations training courses and seminars for all levels of supervisors and managers is continuing. This program should further improve the Bureau's record of effectiveness in dealing with labor relations matters.

The Bureau continues to foster constructive and harmonious relationships with its employees and the 17 bargaining units which represent them. In keeping with the spirit and intent of the newly enacted Civil Service Reform Act of 1978, management deals with 16 AFL–CIO affiliate unions representing 25 distinct craft groups, a noncraft unit, and a guard unit. One independent union represents the GS clerical/technical employees. Fifteen substantive negotiated labor-management agreements are presently in force. Various provisions of the labor agreements are being revised as the Bureau strives to come into compliance with the new law.

Compressed work schedules

The first compressed work schedule among a group of unionized Federal sector employees was instituted in May 1979, when 22 employees of the Office of Engraving entered on a 4-day workweek. Since then, similar work schedules have been introduced in two other components. The Bureau is studying the feasibility for additional application.

Performance evaluation system and awards

Policies describing the performance evaluation and incentive award programs were revised and implemented during fiscal 1979. These programs are designed to foster supervisor-employee communications regarding performance strengths and weaknesses, and to recognize and reward performance of demonstrable contribution to the organization. Training was afforded to all managers and supervisors in the new program policies.

During fiscal 1979, 293 employees received special achievement awards and 18 employees were recipients of high quality pay increases. Under the employee suggestion phase of the program, 125 suggestions were received, of which 61 were adopted with savings of $474,165. Two summer employees were recognized with cash awards for superior work performance.

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Public relations

The Bureau continues to be one of the major attractions for visitors to the Washington area. Over 500,000 visitors availed themselves of the self-guided tour facilities during fiscal 1979. Additional service to the public was rendered by Bureau exhibit participation at four numismatic and two philatelic events.

OFFICE OF EQUAL OPPORTUNITY PROGRAM

The Office of Equal Opportunity Program assists the Assistant Secretary (Administration) in the formulation, execution, and coordination of the policies and programs related to providing equal employment opportunity for 134,000 Treasury employees nationwide. The Office guides and oversees the implementation of the Department's EEO program and affirmative action plans prepared by 12 component bureaus; is responsible for the processing and adjudication of discrimination complaints from Treasury employees and applicants; and provides for the implementation of objectives associated with the Federal Women's Program and the Hispanic Employment Program.

The following table provides a breakout of the Treasury work force by minority group status and grade grouping.

Department of the Treasury full-time employment by minority group status

	1968	1972	1974	1977	1978	Comparison 1977–1978		Comparison 1968–1978	
						Number	Percent	Number	Percent
Total employees*	82,155	102,813	114,686	123,472	122,295	-1,177	-0.95	40,140	48.86
Black	11,777	15,619	18,216	19,904	19,882	-22	-.11	8,105	68.82
Hispanic	1,052	2,247	3,437	4,417	4,670	253	5.73	3,618	343.92
Native American	79	128	175	194	186	-8	-4.12	107	135.44
Asian American	482	813	1,230	1,330	1,409	79	5.94	927	192.32
Other	68,765	84,006	91,628	97,627	96,148	-1,479	-1.51	27,383	39.82
Total GS employees	76,984	96,085	107,658	112,922	112,007	-915	-.81	35,023	45.49
Black	8,950	12,088	14,697	16,143	16,308	165	1.02	7,358	82.21
Hispanic	886	1,949	3,012	3,668	3,938	270	7.36	3,052	344.47
Native American	75	122	194	175	168	-7	-4.00	93	124.00
Asian American	462	720	1,099	1,175	1,272	97	8.26	810	175.32
Other	66,611	81,206	88,656	91,761	90,321	-1,440	-1.57	23,710	35.59
GS 1-4:									
Total	19,120	24,126	25,526	28,051	26,319	-1,732	-6.17	7,199	37.65
Black	4,947	5,904	6,679	6,600	6,452	-148	-2.24	1,505	30.42
Hispanic	255	791	1,065	1,426	1,424	-2	-.14	1,169	458.43
Native American	25	45	84	47	42	-5	-10.64	17	68.00
Asian American	80	159	181	247	273	26	10.53	193	241.25
Other	13,813	17,227	17,517	19,731	18,128	-1,603	-8.12	4,315	31.24
GS 5-8:									
Total	19,480	27,601	33,295	32,977	34,178	1,201	3.64	14,698	75.45
Black	2,708	4,290	5,569	6,112	6,251	139	2.27	3,543	130.83
Hispanic	264	551	1,008	1,135	1,331	196	17.27	1,067	404.17
Native American	26	35	50	54	46	-8	-14.81	20	76.92
Asian American	141	249	445	385	439	54	14.03	298	211.35
Other	16,341	22,476	26,223	25,291	26,111	820	3.24	9,770	59.79

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Department of the Treasury full-time employment by minority group status—**Continued**

	1968	1972	1974	1977	1978	Comparison 1977–1978		Comparison 1968–1978	
						Number	Percent	Number	Percent
GS 9–12:									
Total	28,893	32,321	35,580	37,960	37,250	-710	-1.87	8,357	28.92
Black	1,144	1,587	2,050	2,920	3,046	126	4.32	1,902	166.26
Hispanic	332	519	803	956	1,021	65	6.80	689	207.53
Native American	21	34	44	59	65	6	10.17	44	209.52
Asian American	186	222	368	409	419	10	2.44	233	125.27
Other	27,210	29,959	32,315	33,616	32,699	-917	-2.73	5,489	20.17
GS 13–18:									
Total	9,491	12,037	13,257	13,934	14,260	326	2.34	4,769	50.25
Black	151	307	399	511	559	48	9.39	408	270.20
Hispanic	35	88	136	151	162	11	7.28	127	362.86
Native American	3	8	16	15	15	-	-	12	400.00
Asian American	55	90	105	134	141	7	5.22	86	156.36
Other	9,247	11,544	12,601	13,123	13,383	260	1.98	4,136	44.73

* Totals include wage board personnel. Grade grouping comparisons are for GS series only.

Efforts continue to focus on the development of a unified framework for achieving measurable EEO results. These include:

1. The utilization of the overall zero-base budgeting objectives system for the integration of the EEO program in the total departmental management process. Quarterly reviews are held with bureau heads and their major staff components to track program progress.

2. The development of a minority management information system with the capability of tracking all personnel actions that affect minorities and women. This system can be utilized at both the departmental and bureau levels for the implementation of the Federal equal opportunity recruitment plan, in accordance with Office of Personnel Management regulations.

3. Pilot career development seminars for 400 women and their male supervisors. This program is designed to help women recognize their potential and analyze their skills; to help managers become more aware of the developmental needs of career-oriented women employees; and to provide approaches to make practical organizational changes to meet these needs and benefit the overall productivity of the unit.

4. The establishment of a computerized discrimination complaint tracking system. Through this computerized system, the Office of Equal Opportunity Program is able to identify the current status of any reported discrimination complaint pending in the Department. The computer, containing 1,617 records, also permits analysis of past complaints back to 1961, and identifies patterns and trends as well as resolutions of complaints already processed.

The Department has issued Department of the Treasury Order No. 101–11, August 24, 1979, entitled "Delegation of Authority Concerning Equal Opportunity Programs," which updates the Office's delegation of authority to conform to the provisions of the latest directives of the Equal Employment Opportunity Commission and the Office of Personnel Management to implement the Civil Service Reform Act.

A new directives manual chapter (TD 67–13 January 10, 1979) was issued which delineates the functional responsibilities of EEO and personnel officials.

On October 8, 1978, President Carter signed Executive Order 12086, which eliminated the contract compliance program from Treasury and 10 other agencies, consolidating the contract compliance authority for equal employment opportunity and affirmative action within the Office of Federal Contract Compliance Programs, Department of Labor.

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FEDERAL LAW ENFORCEMENT TRAINING CENTER

The Federal Law Enforcement Training Center is a bureau of the Department of the Treasury which serves as an interagency training facility for Federal law enforcement personnel. Established on May 2, 1970, the Center is under the supervision of the Assistant Secretary (Enforcement and Operations).

The Department of the Treasury is the lead agency for operating the Center and supervises its administrative and financial activities. Training policy, programs, criteria, and standards are established by a Board of Directors comprised of eight members at the Assistant Secretary level representing the major agencies which have organizations participating in the Center. Five are voting members—1 each from the Departments of Interior, Justice, and Treasury; 1 from the General Services Administration; and 1 representing the several other participating organizations with less than 500 law enforcement officers. Three are nonvoting members—one each from the Office of Management and Budget, the Office of Personnel Management, and the U.S. Capitol Police Board.

The Center conducts basic and advanced courses in criminal investigator and police training for the participating organizations. In addition, facilities and support services are provided so that participating organizations may conduct advanced, inservice, refresher, and specialized (AIRS) training for their own law enforcement personnel.

In fiscal 1979, the U.S. Customs Service discontinued the training of its law enforcement personnel in the Washington, D.C., area and began full participation in the Center's programs and facilities. Currently, 36 enforcement organizations, representing both the executive and legislative branches, participate in the Center's programs. The Center also furnishes training on a space-available, reimbursable basis to personnel from other Federal, State, and local agencies.

The consolidation of Federal law enforcement training at the Center has resulted in improved training programs through incorporating minimum performance requirements and Government-wide proficiency standards. Also, the cost of training has been dramatically reduced. The Center's training staff, consisting of both permanent and detailed instructors, provides the continuity required for applied research and course development based, in part, on the fresh insight and experience from the influx of personnel assigned from the field. The combination of an experienced and dedicated staff with the finest equipment and facilities has allowed the Center to take the lead in providing high-quality training for Government law enforcement personnel.

During fiscal 1979, a total of 8,877 students graduated from the Center, representing a 32-percent increase over fiscal 1978. Student-weeks of training increased approximately 8 percent during the same period.

Training and support facilities

Major projects completed during fiscal 1979 included an expansion and modernization to dormitories, renovation of the former chapel into a 300-seat auditorium, and the expansion and renovation of the dining hall. Projects nearing completion at the end of fiscal 1979 included the construction of a new classroom building and indoor firing range, expansion of the physical training complex, additional driver training facilities, and renovation of the existing training building to provide human relations laboratories and television production studios. Work also continued on new paving, a new energy distribution system, and an improved water/sewer system. All master

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plan construction will be completed during fiscal 1980, and will provide the most complete law enforcement training facilities in the Nation.

Training programs

Criminal investigator training.—During fiscal 1979, 17 basic 7-week criminal investigator classes were conducted with 607 students graduating. In addition, the Criminal Investigator Training Division (CITD) staff conducted thirteen 1-week advanced law enforcement photography classes, graduating 122 students. The CITD staff also continued to provide instructional support as needed to the organizations conducting AIRS training at the Center.

In response to a major training need expressed by many of the Center's participating organizations, the CITD staff developed a 2-week white collar crime seminar to train investigators and auditors in the techniques and procedures involved in the recognition and investigation of fraud and related financial crimes. The first seminar was conducted in December 1978, with a formal review of the curriculum by all the participating organizations occurring during July 1979. Minor modifications were made to the seminar as a result of the review, with one seminar subsequently scheduled each month during the remainder of fiscal 1979. The seminar was conducted 7 times during the year, graduating 258 students. This program was well received by the participating organizations, which have projected a need to train an additional 1,000 personnel.

The CITD's training schedule was significantly revised during fiscal 1979 to improve the presentation and sequence of subjects and practical exercises. This revision also included the incorporation of improved examination and evaluation procedures. Other improvements made to the CITD program during fiscal 1979 included the revision of several texts and practical exercises, the development and production of video tapes and other aids to support training, and the upgrading of the performance of role players used in the practical exercises.

A total of 987 students graduated from the various programs conducted by the CITD during fiscal 1979, representing a 3-percent increase over fiscal 1978.

Police training.—The Police Training Division (PTD) conducted basic classes ranging in length from 4 to 16 weeks, graduating a total of 1,730 students during fiscal 1979. This represents a slight decrease from the number of students graduated during the previous fiscal year. However, the PTD staff dramatically increased its instructional support of AIRS programs conducted by the participating organizations.

The PTD staff led the development of a new 9-week training program designed to meet the training needs of several organizations engaged in law enforcement in land management and recreation areas. The program underwent only slight revision after the initial classes were conducted and reviewed by the participating organizations.

A new program to train U.S. Customs Service Inspectors was also developed by the PTD staff, in cooperation with Customs personnel. Four weeks of basic training in common subjects is being conducted by the PTD staff, with the remaining 5 weeks of specialized training conducted by Customs personnel.

Continued improvements and refinements to the various training programs were instituted, including the establishment of the position of testing clerk, resulting in increased control and validity of examinations. Research was initiated in the use of biofeedback therapy in human relations training, which will improve the ability to demonstrate the negative effects of stress. A

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computerized program for monthly reports was developed, subsequently adopted by all training divisions, and resulted in a savings of three staff-days per month. Midcourse practical exercises were initiated for the land management/recreation program, and a video-taped orientation to the final practical exercises was developed. An explosives demonstration by Bureau of Alcohol, Tobacco and Firearms personnel, using armed explosives, was incorporated into the introductory courses on bombs and explosives. This serves as an example of how training can be improved through interagency cooperation and the use of a single facility by all organizations.

Special training.—The special training programs in driving, firearms, and physical activities not only form a part of the basic programs for criminal investigators and uniformed police, but also support the AIRS training conducted by the participating organizations. The number of students participating in Special Training Division (STD) programs increased substantially over fiscal 1978, primarily because of the large increase in AIRS training.

The first Special Training Division Workshop was held at the Center in August 1979, bringing representatives of the participating organizations together to review current programs. This workshop resulted in minor revisions to the programs to better meet the needs of the organizations and, again, serves as an example of the effectiveness of the consolidated approach to training.

The staff of each of the branches of the STD continued to revise and update program content and materials to incorporate the most recent teaching techniques and law enforcement procedures. The Physical Training Branch extended its training certification options to incorporate the American Heart Association program in cardiopulmonary resuscitation (CPR). The Center and participating organizations are increasing the emphasis placed on CPR training, due primarily to the success numerous students trained and certified in CPR have realized in reviving victims. Over 2,300 students were certified in CPR by the Physical Training staff during fiscal 1979. A 4-hour course in motivation and awareness was developed in response to a request by the U.S. Marshals Service, and a 36-hour physical training program was developed in cooperation with PTD staff and Customs training personnel to be a part of the basic training for U.S. Customs Inspectors. Research continued during the year on minimum physical proficiency standards for FLETC students.

The Driver Training Branch staff revised course outlines and lesson plans to incorporate information and material on energy conservation through driving techniques. Video tapes to be used as an orientation to the highway response course and a training aid for teaching "violator stops" were produced. In addition to supporting the basic and AIRS training programs, the Driver Training staff conducted driver training instructor training for officers of selected State and local law enforcement organizations.

The Firearms Training Branch developed and implemented three-dimensional targets to add realism to training. In addition, a new target referred to as the TRANS-TAR was developed to aid in the student's transition from the bull's-eye to the silhouette targets. A video tape was produced to aid in teaching proper sight alignment and trigger control, and a new training aid was built which dramatically demonstrates their importance. The Firearms Training staff developed and initiated a firearms instructor course, from which 138 students graduated in fiscal 1979. An advanced shotgun survival course and automatic weapons familiarization course were also developed and presented as part of AIRS programs conducted by the participating organizations.

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Advanced, inservice, refresher, and specialized training.—AIRS training accounted for the major portion of the large increase in the number of students trained at the Center during fiscal 1979. During the year, 6,560 students graduated from these programs conducted by either the Center or participating organizations, resulting in a 60-percent increase over fiscal 1978. This increase is a result of the availability of new and improved facilities and the identification of subjects in which several organizations need advanced training. It is expected that the amount of AIRS training will continue to increase as new facilities become available, as additional organizations begin participating in the Center, and as new training requirements are identified.

Training support

The Center's Training Coordination Branch acquired microfilm equipment during fiscal 1979 and implemented procedures for filing basic training records. The use of this equipment has reduced retrieval time for transcripts and records by 75 percent, in addition to the obvious benefits of space utilization. Conversion to a computerized system for compiling student registration data relative to attendance, travel, academic performance, and dormitory utilization during fiscal 1979 has also resulted in substantial savings of staff time. The Branch also continued the expansion of its word processing system to provide services for the participating organizations with permanent staffs at the Center.

The production of graphic arts material by the Instructional Services Branch for training and administrative use increased by 30 percent over fiscal 1978. All video tapes developed by the training divisions as aids to instruction were also produced by this Branch. Procedures for handling printed training materials were streamlined, resulting in a 10-percent increase in productivity in this area. During fiscal 1979, the staff standardized procedures for justifying the planning and production of audiovisual products to comply with OMB Circular A-114. Through a review and reduction in the project scope, this staff lowered the cost of the audiovisuals system for the new training building by 50 percent from original estimates.

The Office of Research and Evaluation completed its first year of operation during fiscal 1979, establishing operating policies and relationships. This staff developed and implemented a self-paced instructor training course and graduated 170 students from a basic instructor refresher course. Research studies completed during fiscal 1979 included "The Effectiveness of the Four-Week Capitol Police Program," conducted in cooperation with the PTD; "Driver Training and Firearms Training Issue Papers"; the "Use of Television in Center Training"; and "Electronic Surveillance Training Needs Assessment." The office has begun an interagency, multioccupational job and task analysis that will enumerate all basic and common tasks performed by law enforcement personnel of each of the Center's participating organizations. When completed in fiscal 1980, the results of the task analysis will be used to further refine and validate the Center's programs.

The athletic trainer provides treatment for muscle and ligament injuries, enabling students to continue in the training programs and resulting in a reduction of lost training time due to the injuries. During fiscal 1979, approximately 1,700 students were treated. Additional therapy equipment and treatment areas were developed during fiscal 1979, substantially improving the Center's capability to provide rehabilitative treatment for injured students.

During its first full year of operation in fiscal 1979, the Student Recreation Branch organized and conducted 22 class-oriented team tournaments in

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softball, basketball, and volleyball. In addition, road races, golf and tennis tournaments, and swimming meets were conducted for individual competitors. Special activities such as tours and weekend trips, table games, transportation to local musical performances, and live entertainment on location at the Center were financed by the Employee Recreation Association and conducted by the Recreation Branch. These athletic and recreational activities are conducted 7 days a week, during the students' nontraining hours, and visibly enhance student morale and contribute to the creation of a complete learning environment.

The Center's Printing and Reproduction Branch set new records during fiscal 1979, producing more than 16 million copies. The staff of this Branch exceeded accepted production standards most months during the fiscal year. The highest output for a single month was 145 percent of standard, while most other months ranged from 103 percent to 125 percent of standard. The addition of a high-speed copier to the production equipment assisted the staff in providing service not only to the Center staff, but also to the participating organization staffs at the Center.

Administration

An audit of the Center's financial activities for fiscal 1978 was conducted by auditors of the Bureau of Alcohol, Tobacco and Firearms, and found that financial operations were being carried out in a satisfactory manner. These financial operations were further improved during fiscal 1979 through the implementation of a cash management program.

The development and use of computer programs to account for student travel costs, facility operation and maintenance costs, and student demographic data resulted in greater control over both training and administrative costs.

Substantial effort was devoted during fiscal 1979 to the implementation of the Civil Service Reform Act of 1978 as it applies to bureau operations, and continued emphasis was placed on the Center's equal employment opportunity Affirmative Action program. Extensive external contacts were made to explain the Center's continuing objective of recruiting women and minorities. The graduate and undergraduate intern programs initiated during the previous year were expanded during fiscal 1979, and now include placement of interns in each training division, the Student Recreation Branch, Office of the Athletic Trainer, and several administrative offices. The American Federation of Government Employees has exclusive recognition for Center employees, and local 2002 and Center officials met throughout the year to discuss and resolve areas concern.

Management improvement

The Center continued its established trend of further reducing the training cost per student during fiscal 1979. This is especially significant considering the dramatic financial inflation which has occurred. This cost reduction was due in large part to innovative ideas and concepts by the Center's staff, although some cost benefits were derived from further consolidation. Productivity increases resulted from these reductions in costs.

Approval for a proposed reorganization of the Center staff was received at the close of fiscal 1979 after a year-long study by Treasury and the Office of Personnel Management. A major feature of the reorganization, which will occur during early fiscal 1980, is the consolidation of the instructor staffs allowing greater flexibility in instructor assignments and further increasing

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their productivity. Additional increased productivity is also projected by consolidating several training support functions.

The management information system developed during the previous year was refined and expanded during fiscal 1979, increasing management's opportunity to review existing operations and plan for the future.

FISCAL SERVICE

Bureau of Government Financial Operations

The functions of the Bureau are Government-wide in scope. The Bureau disburses by check, electronic funds transfer, or other means of payment for most Government agencies; settles claims involving loss or forgery of Treasury checks; manages the Government's central accounting and financial reporting system by drawing appropriation warrants, by maintaining a system of accounts integrating Treasury cash and funding operations of disbursing and collecting officers and of Government program agencies including subsystems for the reconciliation of check and deposit transactions, and by compiling and publishing reports of budget results and other Government financial operations. The Bureau also provides banking and related services involved in the management of the Government's cash resources; under specified provisions of law is responsible for investing various Government trust funds; oversees the destruction of currency unfit for circulation; provides central direction for various financial programs and practices of Government agencies; and directs a variety of other fiscal activities.

Disbursements and check claims

During fiscal 1979, the Division of Disbursement operated 11 disbursing centers servicing over 1,600 Federal administrative offices throughout the United States and in the Philippines. The Division also rendered disbursing services for embassies located in Central America, South America, and the Far East. In addition to its disbursement activities, the Division prepared and distributed Federal tax deposit forms for the Internal Revenue Service.

Management improvements and significant achievements.—The Division of Disbursement has been phasing in the presort program since November 1976. To obtain a 2-cents-per-item postage discount for those items that qualify, checks are sorted into ZIP code sequence, placed in trays labeled to the 5-digit or 3-digit postal destinations and released to the Postal Service in this manner thus permitting direct shipment to the delivery points. The Division is presorting each month an average of 31 million social security, supplemental security income, veterans compensation and pension, veterans education, railroad retirement and veterans employees salary checks, as well as approximately 50 million tax refund checks during the peak period of February through June. In fiscal 1979, there was a postage discount of $8,881,002 with a net savings of $8,188,631 after operating costs. During fiscal 1980, the Division will begin presorting civil service annuity checks, thereby adding approximately 700,000 to the monthly volume of presorted payments, and will explore the feasibility of presorting other classes of payments. It is

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expected that net savings from presorting will be in the area of $8 million each fiscal year.

The conversion of VA nonreceipt claims from a manual operation to a magnetic tape transmission system was accomplished in fiscal 1979. Stop payment requests for the social security, supplemental security income, and income tax refund programs processed under the tape claims system totaled 615,182, or approximately 47 percent of the total stop payments requested during the year. Office of Personnel Management and Railroad Retirement Board claims are scheduled for conversion to the system in fiscal 1980.

In fiscal 1979, 118,717,043 social security, railroad retirement annuity, civil service annuity, veterans compensation and pension, miners benefit, and revenue sharing payments were issued using Treasury's electronic funds transfer recurring payment system (EFT). Extension of EFT to Federal salary payments was begun in September 1978 for the National Aeronautics and Space Administration, Langley, Va.; in March 1979 for the Small Business Administration; and in May 1979 for the Veterans Administration. Seminars presenting this program to all Federal agencies were held in September 1979. Plans are to extend the program, whereby all Federal employees may elect to have their net salary payment sent to a financial organization via EFT, thus replacing the composite check program.

An automated claims/after payment actions system is currently under development for implementation on the new computer equipment expected to be acquired for use at the regional disbursing centers in fiscal 1981. This standard system is expected to facilitate the responsiveness of the Treasury Department to claims of payment nonreceipt, and to expedite the reclamation process for both check and EFT payments. These objectives will be accomplished through the capability to process more claims through the automated system, to automatically research and verify claims for an increased number of payments, and to computer generate and control EFT reclamation and trace actions processed at the disbursing centers.

A total of 5,487,825 payments were issued in fiscal 1979 using optical character recognition (OCR) equipment which electronically captures payment data by scanning specially prepared OCR voucher schedules. The captured payment data is transferred onto a magnetic tape for computer preparation of the checks. The eventual conversion of all manual payments to OCR processing is a primary goal of the Division of Disbursement. In this regard plans are being formulated to conduct a followup conversion campaign through OCR training seminars to realize an estimated additional annual savings of $100,000.

The Division of Disbursement is conducting a feasibility study involving the acquisition of new computer output microfilm (COM) equipment to replace that acquired in the early 1960's. Microfilm provides a permanent record of check issues and is used for processing of check claims and inquiries received from claimants and other Government agencies. Disbursing centers submit magnetic tapes containing issue record information to the Chicago Disbursing Center for centralized microfilming. The estimated purchase cost of new COM equipment is less than $300,000. Eight-year system's life cost savings by upgrading the microfilm equipment and operating procedures is approximately $1 million.

Disbursing operations.—During fiscal 1979, a total of 690,721,797 checks, savings bonds, adjustments and transfers, and EFT payments were issued under Treasury's centralized disbursing system at an average cost of $0.046. In addition, 120,189,769 Federal tax deposit forms were prepared and mailed.

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The following table is a comparison of the workload for fiscal years 1978 and 1979:

Classification	Volume 1978	Volume 1979
Operations financed by appropriated funds:		
Checks and electronic funds transfers:		
Social security benefits	390,317,774	397,000,003
Supplemental security income payments	52,050,282	51,803,361
Veterans benefits	76,410,883	73,423,603
Income tax refunds	69,399,321	69,616,637
Veterans national service life insurance dividends	2,278,299	2,820,338
Other	73,115,661	72,783,088
Savings bonds	7,966,722	7,534,414
Adjustments and transfers	249,471	228,225
	671,788,413	675,209,669
Operations financed by reimbursements:		
Railroad Retirement Board	13,871,202	13,591,797
Bureau of the Public Debt (General Electric Co. bond program)	1,795,591	1,920,331
Total workload—reimbursable items	15,666,793	15,512,128
Total workload	687,455,206	690,721,797

Settling Check Claims.—The automated reclamation system implemented in the Division of Check Claims has improved cash flow to the Treasury by automating followup demands previously generated manually. The system has also provided faster, more accurate accounting for accounts receivable and funds collected through the banking community.

Arrangements were completed in August 1979 with the Veterans Administration whereby claims data is submitted to disbursing offices on magnetic tape rather than paper documents. Negotiations are continuing with the Office of Personnel Management, Railroad Retirement Board, and the Defense Department for similar tape claims submission.

Check claims operations.—The Division of Check Claims adjudicates and settles claims against the United States on Treasury checks that are lost in the mails, or which bear forged endorsements, and issues new checks to authorized payees. Substitute checks are issued on claims where the original check that was issued is determined to be outstanding at the time the claim is received. Settlement checks are issued when the original check is found to be paid with a forged endorsement.

In fiscal 1979, 572,099 substitute checks were authorized to replace checks that were lost, stolen, destroyed, or not received. In addition, 30,877 settlement checks were issued to payees, 4,267 to endorsers, and 41,123 to other agencies for death and nonentitlement cases.

Claims modernization project.—During fiscal 1979, additional progress was made to improve and modernize the processing of claims for Treasury checks. A tracking system for claims-processing time and a reporting system to record volumes of work completed have been implemented. A nationwide followup system for handling critical nonreceipt claims has been negotiated with the Social Security Administration.

Agreements were reached with the U.S. Secret Service concerning the format of a new claim form, processing times, and other related matters.

Pursuant to Public Law 95–380, September 22, 1978, a regulation change was made to authorize the issuance of substitute checks without undertakings

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of indemnity, except as the Secretary of the Treasury felt such security was necessary to protect the interests of the United States. This resulted in faster processing of outstanding claims for approximately 12,000 claimants per year. A proposed regulation concerning forms of endorsement on Treasury checks has been published in the Federal Register for public comment. The proposal would require that an endorser evidence representative capacity on a Treasury check when he/she signs for the payee. A comprehensive review of other statutes relating to claims processing is being conducted to identify further legislative and regulatory initiatives which could be taken to achieve more effective and efficient service to the public.

Government-wide accounting

Government accounting systems.—The Treasury Financial Communications System (TFCS) has been in operation since September 1976, and during fiscal 1979 processed a monthly average of $5.3 billion for deposit transactions and $3.2 billion for payment transactions. Utilizing a computer link to the Federal Reserve Bank of New York, this system provides access to the Federal Reserve Communications System and its associated financial data. TFCS automates the generation of nonrecurring payments and the receipt of Government deposits, and provides a comprehensive accounting and audit control mechanism for streamlining financial recordkeeping and reporting. At the close of fiscal 1979, the deposit message retrieval subsystem (a TFCS subsystem developed to allow agencies to receive immediate hardcopy notification of incoming messages by accessing the TFCS with a terminal device on the day that deposits are expected) was being utilized by 15 Government entities. In July 1979, the Letter of Credit-TFCS (LOC-TFCS) was implemented on a pilot basis. The LOC-TFCS represents a major new initiative to utilize electronic funds transfer and data processing technology to improve the Government's cash management objectives. It has the potential to substantially improve the control of Federal advances made under the letter-of-credit method.

Following recent congressional hearings which indicated major weaknesses in agency debt collection systems, special reporting requirements were issued to obtain accounting information and financial data on agency debt collection practices. The instructions, released in TFRM Bulletin 79–10, will help stimulate more effective accounting control over accounts and loans receivable and encourage more aggressive collection of past-due debts. Reporting requirements were revised to provide that accounts receivable not due within a year be classified as noncurrent assets and unrecovered beneficiary overpayments be shown as accounts receivable. In addition, the bulletin interim instructions also establish that consideration be given to past collection experience in computing an allowance for uncollectable accounts; uncollectable accounts written off during specified periods be reported; and agencies provide an aging schedule of accounts and loans receivable as of September 30, 1979, as part of a report of the "Status of Accounts and Loans Receivable."

Published early in fiscal 1979, the third prototype consolidated financial report, like its predecessors, serves as an impetus for improving Federal accounting and contributes to the improvement of accounting at all levels of government. The current report reflects greater accuracy through improved methods of estimating such items as accrual of taxes receivable and others. Future reports will benefit from improvements in the data submitted to Treasury by Federal agencies on such items as estimates of losses on accounts and loans receivable. Under the chairmanship of Comptroller General Staats,

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the Interagency Advisory Committee on Consolidated Financial Statements is finding solutions to conceptual and technical problems facing the consolidation project through Federal task groups on, for example, valuation of assets, pension and inflation reporting, and loss reserves on insurance and loan guarantees.

In accordance with the President's program for effective domestic and monetary policies to assure a strong dollar, the Treasury announced plans on November 1, 1978, to borrow up to $10 billion in foreign currencies through the issuance of public debt securities denominated in foreign currencies. Procedures were developed for accomplishing the transactions associated with the issuance and redemption of these securities. On December 15, 1978, the Treasury issued the first of these foreign currency securities in deutsche marks. On January 26, 1979, the Treasury issued foreign currency securities in Swiss francs.

Prior to the District of Columbia Self-Government and Governmental Reorganization Act (Public Law 93-198), the District of Columbia Government handled all financial transactions through the Treasury general account. All revenues and payments were deposited with the Treasury, and Treasury checks in payment of city obligations and debts were drawn against these funds. In June 1978, the D.C. Government transferred the funds from the Treasury to local commercial banks and began issuing checks against the commercial accounts. A year following the transfer, approximately 35,000 Treasury checks amounting to $2.2 million remained outstanding. A memorandum of understanding was signed between the District of Columbia and the Treasury transferring liability for the oustanding checks to the District. Under the terms of the understanding, the Treasury will continue to honor checks presented for payment and obtain reimbursement from the D.C. Government.

Treasury Department Circular 655 was amended effective September 1, 1979, to allow the delivery of U.S. Government checks to China. The immediate effect of this amendment, which was made in accordance with the Consular Agreement entered into on January 31, 1979, is to permit the delivery of U.S. Government benefits such as social security, veterans benefits, and civil service retirement benefits. Claims that accrued prior to May 6, 1971, remain blocked under the Foreign Assets Control Regulations.

The BANK ON US promotional campaign encourages employees to authorize sending their net salary payments directly to finanical organizations for credit to their personal accounts. The Government-wide promotion which was conducted in early fiscal 1979 resulted in eliminating an additional 240,000 checks each year. Under the regulations governing withholding of certain state and local taxes by Federal agencies (31 CFR 215), the Secretary of the Treasury has entered into tax withholding agreements with 41 States and 50 cities or counties.

In an ongoing effort to simplify and eliminate Government regulations, the Bureau is codifying all Division of Disbursement circulars into the Treasury Fiscal Requirements Manual for the guidance of Government departments and agencies. The ongoing review will result in the codification or rescission of all Division of Disbursement circulars. In addition, the Bureau conducted an extensive study of Treasury Department circulars. It has responsibility for 172 of these circulars which are being reviewed for possible codification in the TFRM and further action or disposition as necessary.

Assets and liabilities in the account of the U.S. Treasury.— Table 53 in the Statistical Appendix shows the balances at the close of fiscal years 1978 and 1979 of those assets and liabilities comprising the account of the U.S.

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Treasury. The assets and liabilities in this account include the cash accounts reported as the "operating balance" in the Daily Treasury Statement. Other assets included in the account of the U.S. Treasury are gold bullion, coin, coinage metal, paper currency, deposits in Federal Reserve banks, and deposits in commercial banks designated as Government depositaries.

Treasury's gold balance was $11,667.7 million at the beginning of the fiscal year and $11,227.7 million at the yearend.

Stocks of coinage metal stood at $261.9 million at the beginning of fiscal 1979 and $295.5 million at yearend. Such stocks included silver, copper, nickel, zinc, and alloys of these metals which are not yet in the form of finished coins.

The number of depositaries of each type and their balances on September 30, 1979, are shown in the following table:

Depositaries	September 30,1979	
	Number of Accounts[1]	Balance
Federal Reserve banks and branches	37	[2]$6,741,862,086
Other depositaries reporting directly to the Treasury:		
Special demand accounts	92	138,162,123
Other:		
Domestic	14	3,619,307
Foreign[3]	35	14,292,887
Depositaries reporting through Federal Reserve banks:		
General	1,110	77,943,942
Special (Treasury tax and loan accounts)	14,079	17,686,990,104
Total	15,367	24,662,870,448

[1]Includes only depositaries having balances with the U.S. Treasury. Excludes those designated to furnish official checking account facilities or other services to Government officers but not authorized to maintain accounts with the Treasury. Banks designated as general depositaries are frequently also special depositaries, hence the total number of accounts exceeds the number of banks involved.

[2]Includes checks for $252,855,093 in process of collection.

[3]Principally branches of U.S. banks and of the American Express International Banking Corp.

Government officers deposit moneys which they have collected to the credit of the U.S. Treasury at Federal Reserve banks or at designated Government depositaries, domestic or foreign. Certain taxes are also deposited directly by the employers or manufacturers who withhold or pay them. All payments are withdrawn from the U.S. Treasury account.

Cash deposits and withdrawals affecting the Treasury's operating balance are summarized in the following table for fiscal 1978 and 1979.

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Deposits, withdrawals, and balances in the U.S. Treasury account
[In millions of dollars]

	Fiscal 1978	Fiscal 1979
Operating balance at beginning of period	19,104	22,444
Cash deposits:		
Gross tax collections (selected)	404,388	465,722
Public debt receipts	480,758	490,091
Other	65,122	73,591
Total cash deposits	950,268	1,029,404
Cash withdrawals:		
Public debt redemptions	440,402	478,417
Letter of credit transactions:		
Medicare	24,021	27,611
HEW grants	26,516	30,920
Unemployment insurance	9,385	8,579
Other	446,604	482,145
Total cash withdrawals	946,928	1,027,672
Operating balance at close of period	22,444	24,176

Investments.—The Secretary of the Treasury, under specific provisions of law, is responsible for investing various Government trust funds. The Department also furnishes investment services for other funds of Government agencies. At the end of fiscal 1979, Government trust funds and accounts held public debt securities (including special securities issued for purchase by major trust funds as authorized by law), Government agency securities, and securities of privately owned Government-sponsored enterprises. See the Statistical Appendix for tables showing the investment holdings by Government agencies and accounts.

Issuing and redeeming paper currency.—The Treasury is required by law (31 U.S.C. 404) to issue U.S. notes in amounts equal to those redeemed. In order to comply with this requirement in the most economical manner, U.S. notes are issued only in the $100 denomination. U.S. notes represent only a very small percentage of the paper currency in circulation.

Federal Reserve notes constitute over 99 percent of the total amount of currency. The Bureau of Engraving and Printing prints and holds these notes in a reserve vault until needed by the Federal Reserve banks. The Bureau of Government Financial Operations accounts for Federal Reserve notes from the time they are delivered to the reserve vault by the Bureau of Engraving and Printing until redeemed and destroyed.

A comparison of the amounts of paper currency of all classes, issued, redeemed, and outstanding during fiscal years 1978 and 1979 follows:

[In thousands]

	Fiscal 1978		Fiscal 1979	
	Pieces	Amount	Pieces	Amount
Outstanding beginning of period	7,839,184	$94,364,252	9,042,425	$110,192,519
Issued during period	3,823,271	32,056,844	3,670,387	32,141,803
Redemptions during period	2,620,030	16,229,577	3,000,481	19,275,377
Outstanding end of period	9,042,425	110,192,519	9,712,331	123,058,945

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Details of the issues and redemptions for fiscal 1979 and of the amounts outstanding at the end of the year are given by class of currency and by denomination in a table in the Statistical Appendix. Other tables in that volume give further information on the stock and circulation of currency and coin in the United States.

Data processing.—During fiscal 1979, 694.3 million checks were paid and reconciled by the electronic check payment and reconciliation system. These include all checks issued worldwide by civilian and military disbursing offices.

Continued improvements were made to the automation of the central accounting system by producing the Treasury Combined Statement on third generation data processing equipment. This automated system, which consolidates and summarizes all of the cash transactions of the Federal Government, is the data base for Federal budget results published in the Monthly Treasury Statement of Receipts and Outlays of the U.S. Government and in the annual Treasury Combined Statement of Receipts, Expenditures and Balances of the U.S. Government.

Extensive support services were provided to the Divison of Check Claims. Reporting and data collection procedures were improved to better support case tracking and status reporting through the check claims process. Additional automated services were provided for the Treasury check truncation system.

Banking and cash management

Foreign currency management.—During fiscal 1979 the Foreign Currency Staff led a joint Treasury/State/Defense cash management review of military bases and embassies in Korea, Japan, Okinawa, Philippines, Thailand, and Hong Kong. As a result, many new banking procedures were implemented which will result in interest savings of over $300,000 annually.

The Staff also was principally responsible for the development of guidelines for the funding of cooperative production arrangements for the purchase and sale of technology and equipment between agencies of the U.S. Government and foreign nations. These new guidelines are designed to reduce the U.S. Government interest expense by retaining U.S. dollars in the account of the Treasury as long as possible. The Staff will continue to monitor the more than $1 billion of U.S. Government expenditures on these programs.

Federal depositary system.—The types of depositary services provided and the number of despositaries for each of the authorized services as of September 30, 1978 and 1979, are shown in the following table:

Type of service provided by depositaries	1978	1979
Receive deposits from taxpayers and purchasers of public debt securities for credit in Treasury tax and loan accounts	14,063	14,079
Receive deposits from Government officers for credit in Treasury's general accounts.	741	715
Maintain checking accounts for Government disbursing officers and for quasi-public funds	5,395	5,572
Operate limited banking facilities in the United States and its outlying areas	156	157

Paying grants through letters of credit.—At the close of fiscal 1979, 95 Government agency accounting stations were financing with letters of credit under the Federal Reserve bank system. During the period the Bureau processed 135,643 withdrawal transactions aggregating $1,056 million, compared with 145,945 transactions totaling $68,998 million in fiscal 1978.

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At September 30, 1979, 53 Government agency accounting stations were financing with letters of credit under the Treasury regional disbursing office system. During the year, Treasury regional disbursing centers issued 85,522 checks totaling $1,847 million, in response to grantee requests compared with 75,507 checks totaling $19,340 million in fiscal 1978.

Tax and loan investment program.—Pursuant to Public Law 95-147 and 31 CFR Parts 203, 214, 226, 317, and 321, the Treasury implemented the Treasury tax and loan investment program on November 2, 1978.

Treasury invests its temporarily excess operating cash in interest-bearing notes with tax and loan depositaries. Depositaries that wish to retain funds deposited in their tax and loan accounts in interest-bearing note obligations participate under the Note Option. Depositaries that wish to remit the funds to the Treasury's operating account at Federal Reserve banks participate under the Remittance Option. In return for services provided by depositaries, the Treasury pays a fee for each Federal tax deposit processed. The class of financial institutions eligible to be designated as depositaries has been expanded to include savings and loan associations and credit unions.

Prior to implementation, there were 14,079 authorized Treasury tax and loan depositaries. At September 30, 1979, there were 14,079 authorized depositaries. During the period November 2, 1978, through September 30, 1979, the Treasury received revenues as a result of the program totaling 643 million. Fees paid to depositaries during the same period for Federal tax deposits processed totaled 23.5 million.

Destruction of unfit currency.—During fiscal 1979, emphasis continued on the installation of automated high-speed currency-processing equipment. A total of 29 machines have been successfully tested and installed at various Federal Reserve banks. Partially automated banks will continue to process unfit currency under the manual system also until they have been completely automated. Substantial savings are expected when the Federal Reserve banks are completely converted and in full operation.

The 29 machines mentioned above were all manufactured by one company; however, work continues by another company to develop a similar machine with a smaller capacity and which is, consequently, less expensive. This machine will be better utilized by smaller banks. The equipment has been tested several times during the year but has not successfully passed all of Treasury requirements. Approval may be forthcoming sometime during fiscal 1980.

Cash management policy.—Chapter 8000 of part 6 of volume I of the Treasury Fiscal Requirements Manual, which prescribes the cash management procedures to be observed by all Government entities whose financial transactions affect the cash account of the Treasury, was revised on May 7, 1979. The revisions provide for additional charges on late payments involving amounts due the Government which are not otherwise covered by contracts, agreements, or other formal payment arrangements.

The procedural requirements contained in Chapter 8000 were re-emphasized to the Federal sector through the issuance of Treasury Fiscal Requirements Manual Bulletin No. 79-07 on May 25, 1979. This bulletin also transmitted a questionnaire which required all Government departments and agencies to report progress with respect to compliance with the provisions of Treasury's cash management regulations.

These efforts will focus greater attention on the Government's cash management responsibilities including the payment of bills when due, the use of discounts, the monitoring of cash flow, and the reduction of debt through the application of charges for late payments.

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Division of Currency Claims.—During fiscal year 1979, more than 48,500 mutilated currency claims were received and over $10 million was paid out in settlement thereof. At the end of the year, only 217 cases remained unprocessed. Nearly all of these are classified as "difficult" because considerable processing time is required due to the degree to which the currency has been burned or mutilated.

Operations planning and research

The Operations Planning and Research Staff is continuing its systems developmental activities for a number of fiscal functions including the following major system revisions:

(1) The Treasury and the Federal Reserve completed implementation of the check truncation system. Under this system the flow of paid Treasury checks stops at the Federal Reserve bank level. Magnetic tapes and microfilm records are prepared for the hundreds of millions of checks which are shipped to Treasury for final payment and reconciliation. Work is continuing to further improve the system by reducing processing times.

(2) The electronic funds transfer recurring payment system, through which recipients of recurring Federal payments receive credit directly in their accounts at their financial organizations, has been expanded to encompass over 12 million payments a month. Approximately 118.7 million Treasury payments were made under the system during fiscal 1979. In 1979, the system was expanded to include the salary payments of two additional agencies as part of a pilot program. The salary payments of additional agencies will be brought into the program during 1980. Also during 1979, the staff coordinated with the Department of the Army the successful implementation of their retirement payments into the system.

Miscellaneous fiscal activities

Auditing.—During fiscal 1979 the Audit Staff issued 73 audit reports on financial, compliance, and operational matters. The audits ranged from small imprest funds to the accounting for multibillion-dollar Federal trust funds and the audit of U.S. Government-owned gold. Onsite examinations were made at several of the Bureau's disbursing centers throughout the United States. Also, onsite audits were made of the cancellation, verification, and destruction of unfit currency at virtually all of the Federal Reserve banks and branches. In addition, a special audit of the electronic funds transfer system was conducted. Substantial improvement in operations in internal controls resulted from the audits.

Also, the Audit Staff began an overall audit of the Treasury tax and loan operations. Federal Reserve bank audit reports on the tax and loan investment program will be utilized in analyzing Bureau operations to pinpoint potential problem areas. In addition, savings and loan associations and credit unions may accept Treasury tax and loan deposits if they are federally insured or insured by a Treasury approved State insurance plan. The Audit Staff devised the general standards for qualifying State insurance plans, and applications are now being accepted for Treasury approval.

During fiscal year 1979 several auditors were assigned to special projects. Two were members of the Check Claims Modernization Task Force and two additional auditors were assigned to the Small Business Administration Task Force. In addition, an auditor served on an interagency study of the personal accountability of certifying and disbursing officers in the Government, sponsored by the Joint Financial Management Improvement Program. An auditor was also assigned to the Department of the Treasury Office of Audit,

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to assist in the development of an overall audit program for the Treasury payroll/personnel information system. Another auditor served as a member of the Secretary's Committee for the Audit of the Exchange Stabilization Fund.

As a result of the annual Audit Staff examination of the financial statements and related supporting information of surety companies, approximately 285 companies qualified for certificates of authority as acceptable sureties and reinsurers on bonds running in favor of the United States (6 U.S.C. 6–13). Certificates are renewable each July 1 and a list of approved companies (Department Circular 570) is published annually for the information of Federal bond-approving officers and persons required to give bonds to the United States.

Loans by the Treasury.—The Bureau administers loan programs with those corporations and agencies that have authority to borrow from the Treasury. See the Statistical Appendix for table showing the status of those Treasury loans at September 30, 1979.

Federal Financing Bank.—During the period, loans outstanding were increased by $16.1 billion, resulting in a balance at the end of fiscal 1979 of $64.2 billion. Interest of $4.6 billion was collected from borrowers and $4.5 billion was paid on borrowings from the Secretary of the Treasury. See the Statistical Appendix for comparative financial data for the Federal Financing Bank.

Liquidation of Reconstruction Finance Corporation assets.—The Secretary of the Treasury's responsibilities in the liquidation of RFC assets relate to completing the liquidation of business loans and securities with individual balances of $250,000 or more as of June 30, 1957, and securities of and loans to railroads and financial institutions. Net income and proceeds of liquidation amounting to $60 million have been paid into Treasury as miscellaneous receipts since July 1, 1957.

During the year $196,000 had been collected and $1.6 million written off as uncollectable, reducing unliquidated assets to zero.

Liquidation of Postal Savings System.—Effective July 1,1967, pursuant to the Act of March 28,1966 (39 U.S.C. 5225-5229), the unpaid deposits of the Postal Savings System were transferred to the Secretary of the Treasury for liquidation. As of June 30, 1970, a total of $65.1 million, representing principal and accrued interest on deposits, had been transferred for payment of depositor accounts. All deposits are held in trust by the Secretary pending proper application for payment. Payments for fiscal 1979 totaled $215,945. Cumulative payments amount to $58.7 million plus pro rata payments to the States and other jurisdictions of $6 million. The undistributed funds balance as of September 30,1979, was $381,866.

Government losses in shipment.—Claims totaling $226,753 were paid from the fund established by the Government Losses in Shipment Act, as amended (40 U.S.C. 721-729). Details of operations under this Act are shown in the Statistical Appendix.

Donations and contributions.—The Bureau received "conscience fund" contributions totaling $83,789 and other unconditional donations totaling $198,870. Other Government agencies received conscience fund contributions and unconditional donations amounting to $29,512 and $105,608, respectively. Conditional gifts to further the defense effort amounted to $5,585. Gifts of money and the proceeds of real or personal property donated in this period for reducing the public debt amounted to $550,204.

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Foreign indebtedness

World War I.—The Governments of Greece and Hungary made payments during fiscal 1979 of $81,789 and $60,320, respectively. For a complete status of World War I indebtedness to the United States, see the Statistical Appendix.

Credit to the United Kingdom.—The Government of the United Kingdom made principal and interest payments of $75.7 million and $57 million, respectively, which were due on December 31, 1978, under the Financial Aid Agreement of December 6, 1945, as amended March 6, 1957.

Indonesia, consolidation of debts.—The Government of the Republic of Indonesia made payments in fiscal 1978 of $1,001,682 in principal and $103,106 interest on deferred principal installments, in accordance with the Indonesian Bilateral Agreement of March 16, 1971. The normal payment of interest on principal is not due until June 11, 1985.

Payments of claims against foreign governments

The 19th installment of $2 million was received from the Polish Government under the Agreement of July 16, 1960, and pro rata payments on each unpaid award were authorized.

The seventh installment of $4,110,000 was received from the Hungarian Government under the Agreement of March 6, 1973. The seventh installment was greater than the minimum installment of $945,000 because 6 percent of the dollar proceeds of imports into the United States from Hungary for the 12 months ending December 31, 1978, exceeded the minimum installment by $3,165,000 thereby raising the annual installment from $945,000 to $4,110,000. This pro rata payment has been authorized to all entitled awardholders, and payments are now being made.

The total amount of $8,835,000 was received by the Department of the Treasury and deposited into the War Claims Fund. Pro rata payments were authorized to all entitled awardholders. These funds will be the last funds available for payment on awards certified by the Foreign Claims Settlement Commission under Title II of the War Claims Act of 1948, as amended.

Administration

Equal employment opportunity.—In January 1979, the Bureau set a goal of filling 40 percent of available opportunities to hire and promote in grades GS-12 and above with minorities and women. Of the 42 available opportunities to hire and promote in these grades, 17, or 40.5 percent, were filled with minorities and women.

The Bureau has also made excellent progress in the resolution of EEO complaints. During fiscal 1979, nine complaints were filed at the Bureau. At yearend, only two of those nine remain to be adjudicated. The resolution of complaints prior to the hearing or court stages, contributes to substantial financial savings to overall Bureau EEO discrimination complaint costs.

Procurement Activity.—Two significant advances were made in this area. There was an increase in the use of the imprest fund for small purchases, thus eliminating unnecessary expenses and paperwork in processing purchase orders, receiving reports, and payment invoices. Additionally, the Bureau accomplished a 650 percent increase in the award of contracts to 8(a) minority firms. Thirteen contracts, valued at $690,400, were awarded in 1979 compared with two contracts at $92,000 in fiscal 1978.

Paperwork Management Activity.—Eleven copier machines were purchased in September 1978, with an actual savings of $41,996 as of September 30,

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1979. Two additional copiers were purchased in September 1979, with a projected 5-year savings of $34,400.

A micrographics feasibility study, covering the needs of the Division of Government Accounts and Reports, was conducted and a 5-year savings of $162,164 has been projected in addition to a number of nonmonetary advantages.

A computer output micrographics study was conducted for the Division of Data Processing and the Division of Government Accounts and Reports. It was proposed that the Division of Data Processing's largest report, now produced in paper form, be converted to computer output micrographics. A 5-year cost savings of $278,000 is projected.

Labor-management relations.—The Federal Labor Relations Authority has determined that seven of the Bureau's disbursing centers constitute an appropriate residual unit. A certification election has been held, the National Treasury Employees Union (NTEU) won the election, and those disbursing centers are automatically consolidated with the Bureau's existing headquarters unit already represented by NTEU.

During the first 6 months from the effective date of the collective bargaining agreement between the Bureau and NTEU, approximately 40 grievances had been filed by employees and the union. Decisions have been issued regarding all of the union grievances.

Training.—Headquarters managers and supervisors were given in-depth labor relations training regarding management's rights and obligations under the collective bargaining agreement between the Bureau and NTEU. Formal training has been provided to all headquarters supervisory personnel in the development of performance standards. The establishment of these standards will enhance the Bureau's performance appraisal system and provide a systematic means for appraising employees. The Career Development Program for lower level employees continues to be an effective means of selecting and training under-trained employees for higher level and paraprofessional positions. During fiscal 1979, 20 employees were selected and placed through this program. The Bureau participated in the Department's Three-Phase Executive/Management Effectiveness Program. As a result of this team-building training, division and staff heads established a Director's Committee, which meets monthly to discuss issues that cross division/staff lines. An Executive Board was also established consisting of the Commissioner, Deputy Commissioner, Assistant and Associate Commissioners, who meet every 2 weeks. Both the Board and the Director's Committee have been addressing Bureau concerns and problems and have appointed joint task forces to work on specific issues. A "Careers in Management" course was conducted for higher level managers, providing them an opportunity to assess their skills and develop an individual development plan to meet their needs.

Part-time career program.—A part-time career employment program implemented in the Bureau has provided 30 permanent part-time positions which have provided benefits to both management and employees. Through these positions, employment has been provided to students who must finance their education, employees who wish to continue their education or gain new skills, and parents who wish to combine career and family responsibilities. Also, these positions have allowed managers to retain skilled personnel who are unable to continue a full-time work schedule and in some instances overtime work has been eliminated or curtailed by the employment of part-time career employees.

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Bureau of the Public Debt

The Bureau of the Public Debt is responsible for administering the laws and regulations pertaining to public debt financing and operations within the framework of policies established by the Secretary of the Treasury. The Bureau prepares regulations governing public debt securities, and the offering circulars and instructions relating to each offering of the securities; directs the handling of subscriptions and the making of allotments; supervises the public debt activities of fiscal agents and of agencies authorized to issue and pay savings bonds throughout the United States; orders, stores, and distributes all public debt securities; audits and records retired securities and interest coupons; conducts transactions in public debt securities in Washington D.C.; maintains individual accounts with owners of registered securities and book-entry securities and authorizes the issuance of checks in payment of interest and principal on such accounts; adjudicates claims on account of lost, stolen, destroyed, or mutilated securities, maintains accounting control over public debt financial security transactions, security accountability, and interest cost; prepares public debt statements; and supervises the destruction of security items in the Department of the Treasury. The Bureau's principal office and headquarters is in Washington, D.C. An office is also maintained in Parkersburg, W. Va., where most Bureau operations related to U.S. savings bonds, U.S. savings notes, retirement plan bonds, and individual retirement bonds are handled.

Management improvement

Under Treasury's expanded book-entry system, the Bureau currently maintains book-entry accounts for investors who elect not to deal through a financial institution or securities dealer. During fiscal 1979, the first phase of selected automation of these accounts was completed. This has enabled the Bureau to provide Treasury bill investors with computer-generated statements of account and checks for discount and redemption payments. While it is not possible at this time to determine an exact dollar amount saved with this portion of the automation program for book-entry accounts, it has resulted in providing faster service and more timely issuance of discount payments to the public.

Two new series of savings bonds, EE and HH, will be offered for sale as of January 1, 1980. There will not be any further extensions offered on the E and H savings bonds with issue dates between May 1941 and April 1952. It is estimated that the new accrual-type bond will result in a savings of $4,773,000 in fiscal 1980. Annualized savings after 5 years are estimated at $9,347,000. The offering of the new accrual-type bond will also provide an opportunity to improve some of the regulatory provisions of the series E offerings.

Minimum investment yields required to be paid on savings bonds (Public Law 94-32) and payments of fees to savings bond issuing agents (Public Law 95-147) have increased costs of operating the savings bonds program. To compensate for these increased costs, the Bureau has revised the requirements for remittance of sales proceeds. Because of this, the Treasury can realize approximately $1.5 million in monthly savings.

The issues-on-tape program (submission of bond sales on magnetic tape) has been expanded to include eight additional issuing agents. Approximately 67.7 million sales of series E savings bonds were reported on tape by 77 participating agents. This represents 13 percent of total E bond sales and 51 percent of total payroll deduction sales. A recurring annual savings of

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approximately $1,354,000 should be realized based on the volume of issues handled by these agents.

An automated destruction schedule system for redeemed and retired securities has been implemented in the Bureau's Division of Securities Operations which eliminated certain manual procedures in the destruction schedule preparation process. This new automated system saved 0.2 work-years and approximately $2,000.

The computerization of daily summary reports received from Federal Reserve banks was completed during fiscal 1979. When the remaining phases of this project are completed, it will provide the means to produce a computer match of detailed security activity with recap controls to determine the accuracy and completeness of reported data entered into the Treasury and agency securities accounting system (TASAS). This processing will replace a manual reconciliation and verification system and is projected to save $28,500 and 3 work-years during fiscal 1980.

In August 1979, the Division of Financing in the Office of the Commissioner was elevated to Office status. The change was made to give the organization move visibility within the Bureau.

Effective April 8, 1979, the Divisions of Personnel, Management Analysis, Management Services, and Data Processing were reorganized into the Division of Management and Support Services. The consolidation was made to provide a more responsive organizational structure and to strengthen overall management and control of these activities.

In February, the Division of Data Processing of the Savings Bond Operations Office was separated into two divisions: Division of Data Processing with responsibility for operating the computer center, and Division of Data Recording and Search with responsibility for data recording, microfilming, and data search activities. This restructuring will provide a better span of control and enhance managerial effectiveness.

A Bureau-wide management Development Program was established and implemented during fiscal 1979. The program is designed to improve the effectiveness and efficiency of operations by developing the managerial skills of individuals who are now or have the potential to become managers.

Volume II of the Fiscal Agency Securities Manual was issued In May 1979. This volume consolidates the Bureau's instructions to Federal Reserve banks concerning marketable and special securities. Volume II effectively replaced numerous individual issuances. (Volume I, covering savings and retirement securities, was issued in 1978.)

Bureau operations

During the fiscal year, 550,000 individual accounts covering publicly held registered and book-entry securities other than savings bonds, savings notes, individual retirement bonds, and retirement plan bonds were opened, and 254,000 was closed. This increased the number of open accounts to 764,000, covering registered and book-entry securities in the principal amount of $20,963 million. There were 1,140,000 interest and discount checks with a value of $1,069 million issued during the period.

Redeemed and canceled securities received for audit, other than savings bonds, savings notes, and retirement plan bonds, included 1,373,000 bearer securities and 337,000 registered securities. Coupons totaling 7,592,000 were received.

During the period, 38,000 registration stubs of retirement plan bonds, 25,000 registration stubs of individual retirement bonds, 24,000 retirement

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plan bonds, and 10,000 individual retirement bonds were received for audit and recordation.

U.S. savings bonds.—The issuance and retirement of savings bonds result in a heavy administrative burden for the Bureau of the Public Debt, including auditing and classifying all sales and redemptions; establishing and maintaining registration and status records for all bonds; servicing requests from bond owners and others for information; and adjudicating claims for lost, stolen, and destroyed bonds.

Detailed information on sales, accrued discount, and redemptions for savings bonds will be found in the Statistical Appendix.

There were 161 million registration stubs or records on magnetic tape and microfilm received, representing the issuance of series E savings bonds, making a grant total of 4,583 million, including reissues, received through September 30, 1979. All registration stubs of series E bonds are microfilmed, audited, and destroyed, after required permanent record data are prepared by an EDP system in the Parkersburg office.

Of the 161 million series A-E savings bonds and savings notes redeemed and charged to the Treasury during the period, 158 million (97.9 percent) were redeemed by authorized paying agents. For these redemptions the agents were reimbursed quarterly at the rate of 15 cents each for the first 1,000 bonds and notes paid and 10 cents each for all over the first 1,000 for the month of October 1978, and a flat rate of 30 cents thereafter, for a total of $45,507,490.

Payment of fees to issuing agents commenced on November 1, 1978, at the rate of 5 cents for each book-entry reissue, 10 cents for each computerized payroll issue, 30 cents a piece for other payroll issues, and 70 cents for each over-the-counter issue. The issuing agents fees totaled $24,922,768 for the period.

Interest checks issued on current income-type savings bonds (series H) during the period totaled 4,097,000 with a value of $503 million. New accounts established for series H bonds totaled 94,000 while accounts closed totaled 160,000.

Applications received during the period for the issue of duplicates of savings bonds and savings notes lost, stolen, or destroyed after receipt by the registered owner or his agent totaled 60,000. In 36,000 of such cases the issuance of duplicate bonds was authorized. In addition, 19,000 applications for relief were received in cases where the original bonds were reported as not being received after having been mailed to the registered owner or his agent.

OFFICE OF FOREIGN ASSETS CONTROL

The Office of Foreign Assets Control administers five sets of regulations which implement the Department of the Treasury's freezing controls.

The Foreign Assets Control Regulations and the Cuban Assets Control Regulations prohibit, unless licensed, all trade and financial transactions with North Korea, Vietnam, Cambodia, and Cuba and their nationals. These regulations also block assets in the United States of the above-named countries and their nationals.

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Under a general license contained in the Foreign Assets Control Regulations, all transactions with the People's Republic of China are authorized, except transactions abroad by foreign firms owned or controlled by Americans which involve shipment to the People's Republic of China of internationally controlled strategic merchandise unless the transaction is appropriately licensed under the Transaction Control Regulations (see below). Also, transactions in Chinese assets blocked in the United States as of May 6, 1971, remain prohibited.

Under the Agreement Concerning the Settlement of Claims between the Government of the United States and the Government of the People's Republic of China, signed on May 11, 1979, the People's Republic of China agreed to pay $80.5 million in settlement of claims of U.S. nationals for expropriation of property from October 1, 1949, to May 11, 1979, and the United States has agreed to unblock on January 31, 1980, all assets remaining blocked under the Foreign Assets Control Regulations by reason of a direct or indirect interest of the People's Republic of China or nationals thereof. Regulations to implement the agreement will be published prior to January 31, 1980.

During the fiscal year, the Foreign Assets Control Regulations were amended to extend the existing authorization for remittances to close relatives of remitters, who are nationals of Vietnam, to such nationals who are either residents of Vietnam, or of a country in the authorized trade territory or of the People's Republic of China, and to nationals of Cambodia who are residents of countries in the authorized trade territory or of Vietnam.

The Cuban Assets Control Regulations were amended to extend the existing authorization for support remittances to close relatives of the remitter who are nationals of Cuba and resident in Cuba to such nationals who are residents of countries in the authorized trade territory.

The Transaction Control Regulations supplement the export controls exercised by the Department of Commerce over direct exports from the United States to Eastern Europe and the U.S.S.R. by controlling certain goods of foreign origin not subject to Commerce control. These regulations prohibit, unless licensed, the purchase or sale or the arranging of the purchase or sale of strategic merchandise located outside the United States for ultimate delivery to Communist countries of Eastern Europe, the U.S.S.R., the People's Republic of China, North Korea, Vietnam, and Cambodia. The prohibitions apply not only to domestic American companies, but also to foreign firms owned or controlled by persons within the United States. A general license permits sales of these commodities to the listed countries (other than North Korea, Vietnam, and Cambodia) provided shipment is made from and licensed by a Coordinating Committee (COCOM) member country. (COCOM is a NATO entity.)

The Office also administers controls on assets remaining blocked under the World War II Foreign Funds Control Regulations. Those controls continue to apply to blocked assets of Czechoslovakia, Estonia, Latvia, Lithuania, and East Germany and nationals thereof who were, on December 7, 1945, in Czechoslovakia, Estonia, Latvia, or Lithuania, or on December 31, 1946, in East Germany.

On September 12, 1979, the President made a determination that it was in the national interest of the United States to continue for another year, until September 14, 1980, the emergency authorities of section 5(b) of the Trading With the Enemy Act as a basis for the four above-described regulations.

During the fiscal year, the Foreign Assets Control Regulations, the Cuban Assets Control Regulations, and the Foreign Funds Control Regula-

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tions were amended to require all persons holding certain types of blocked assets, such as bank deposits, to hold the assets in interest-bearing accounts in domestic banks. The new requirement will enhance the value of blocked assets potentially available for purposes of negotiations and claims settlement with the countries affected.

Finally, the Office administers the Rhodesian Sanctions Regulations which implement United Nations Resolutions calling upon member nations to impose mandatory sanctions on Southern Rhodesia. The regulations include comprehensive controls on the importation of merchandise of Rhodesian origin. There is also a prohibition, except as licensed, on the importation of ferrochromium produced in any country from chromium ore or concentrates of Rhodesian origin; on the importation of non-Rhodesian chromium ore, except when imported directly or on a through bill of lading; and on the importation from any country of ferrochromium and of steel mill products in their basic shapes and forms which contain more than 3 percent chromium. A general license in the regulations authorizes imports of ferrochromium and of steel mill products that are certified by the government of the producing country not to contain any chromium or ferrochromium of Rhodesian origin.

Under the Foreign Assets Control Regulations and the Transaction Control Regulations, the number of specific license applications received during the fiscal year (including applications reopened) was 128. During that period, 135 applications were acted upon.

Applications for licenses and requests for reconsideration under the Cuban Assets Control Regulations totaled 425 during fiscal 1979. During this period, 399 applications were acted upon.

During fiscal 1979, 486 applications (including applications reopened) were received under the Rhodesian Sanctions Regulations; 309 applications were acted upon.

Eleven applications (including applications reopened) were received under the Foreign Funds Control Regulations; six were acted upon.

Certain broad categories of transactions are authorized by general licenses set forth in the regulations, and such transactions may be engaged in by interested parties without the need for securing specific licenses.

During the fiscal year, investigation of a fraudulent scheme by which funds were obtained from the National Bank of Cuba by use of false documents resulted in the blocking of cash, securities, foreign currency, and other property valued at $946,000 which the perpetrators of the scheme had brought into the United States. An investigation relating to publishing in the United States of Cuban copyrighted music, and royalties due Cuban composers, also involved requiring transfer of $134,000 from the books of the music publishing firm to a blocked interest-bearing account at a domestic bank in accordance with section 515.205 of the Cuban Assets Control Regulations. One criminal indictment was issued charging illegal importation of animal trophies from Rhodesia in violation of the Rhodesian Sanctions Regulations. A U.S. air carrier which had pleaded guilty to an indictment in connection with the unlicensed training of Rhodesian pilots paid a fine of $40,000.

Other investigations of possible violations of the various regulations were also conducted during the year.

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INTERNAL REVENUE SERVICE[1]

The Internal Revenue Service administers the internal revenue laws embodied in the Internal Revenue Code (26 U.S.C.) and certain other statutes, including the Employee Retirement Income Security Act of 1974 (Public Law 93–406, 88 Stat. 829).

Collecting the Revenue

Returns processing

The IRS received 140.2 million tax returns of all types in 1979 compared with 136.6 million in 1978. Over 92.6 million of the returns received were individual and fiduciary income tax returns as compared with 89.1 million in 1978.

The number of forms 1040 and 1040A received in 1979 was 90.7 million compared with 87.3 million in 1978. Forms 1040 received totaled 54.6 million, 2.5 percent more than the 53.2 million received last year. More than 36.1 million individual taxpayers—40 percent of all individual filers—used the short form 1040A compared with 34 million in 1978, an increase of 6.1 percent.

As a result of checking the mathematics on 90.6 million individual returns, 2 million taxpayers were found to have overstated their tax liabilities by $357 million, an average of $159 per return. On 3.8 million returns, taxpayers understated their tax liability by $906 million for an average of $241.

Error rates for both the forms 1040 and 1040A rose slightly in 1979, with 5.5 percent of the 1040A's processed having mathematical errors compared with 5.1 percent for 1978. The error rate for forms 1040 was 7.3 percent in 1979 as compared with 6.5 percent for 1978.

The IRS also checked the amounts claimed for estimated tax payments and found that taxpayers in some cases underclaimed $333 million and overclaimed by $661 million in others.

Receipts

Gross tax receipts in 1979 rose to $460.4 billion, up $60.6 billion over 1978 for a 15.2-percent increase. This gain was larger than the previous record $47.3 billion rise between 1976 and 1977.

Income taxes accounted for over two-thirds of all tax receipts. Individual income taxes totaled $251.5 billion, an increase of $38.5 billion, or 18.1 percent, while corporation income tax receipts were $71.4 billion, up by $6.1 billion, or 9.3 percent. Major factors in this increase were higher personal income and corporate profits.

Employment taxes consisting of social security, self-employment, Federal unemployment, and railroad retirement were $112.8 billion. This rise of $15.6 billion (16 percent) reflected increases in the social security tax rate and wage base.

Excise tax revenue rose to $19 billion, up $0.4 billion, or 2.1 percent, over last year. These collections increased despite the continued phasing out of the telephone excise tax and changes made by the Energy Tax Act of 1978.

Estate and gift taxes, the smallest source of revenue, advanced slightly by $0.1 billion (2.6 percent) on collections of $5.5 billion for 1979.

[1] Additional information will be found in the separate Annual Report of the Commissioner of Internal Revenue.

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Refunds

The IRS paid total refunds of $41.7 billion to 69 million taxpayers. Last year 69 million refunds totaling $39.6 billion were paid. Refunds to individual filers, forms 1040 and 1040A, were $34.9 billion, averaging $518 compared with $495 in 1978. This year's individual refunds included 3.8 million checks totaling $773 million for taxpayers who claimed the earned income credit.

Penalties

Under law, the IRS levies penalties such as those for failure to pay, paying with bad checks, late filing, negligence, and fraud. In 1979, the IRS assessed 21 million penalties of $1.8 billion.

Tax credits

Child care expense credits are available to working parents meeting certain requirements. Earned income credits are offered to low-income taxpayers who maintain a home for themselves and at least one dependent. This year $0.7 billion in child care credits were claimed on 3.4 million returns, and 5.2 million taxpayers received $1 billion in earned income credits. Legislation in 1978 provided advance payment of the earned income credit beginning in 1979. These data will be available when 1979 tax returns are processed in 1980.

The new-jobs credit was replaced in 1979 by the targeted jobs tax credit designed to encourage employment of specific groups. Employers claimed $1.4 billion on 747,000 returns in 1979.

The Energy Tax Act of 1978 allowed taxpayers a credit for energy conservation and renewable energy source expenditures made on their residences. Taxpayers claimed $593 million in credits on 5.8 million returns.

Presidential election campaign fund

This year 23.2 million individual income tax returns had designations for the Presidential election campaign fund—25.8 percent of the returns processed. Designations amounted to $35.9 million compared with $39.1 million designated in 1978 on 24.9 million individual tax returns, or 28.9 percent of those processed. The cumulative amount credited to the fund since it was initiated in 1972 is $207.4 million.

Automated information filing

The IRS received over 327 million information returns from businesses and organizations required to report wages, interest, dividends, and other payments, of which over 264 million were submitted on magnetic media.

Most information returns received on magnetic media and approximately 15 percent of those submitted on paper will be matched against IRS files to verify such amounts taxpayers report on their returns.

Combined annual wage reporting

Combined annual wage reporting (CAWR) is a system developed to reduce the reporting burden for employers. This system, satisfying the reporting requirements of both the IRS and the Social Security Administration (SSA), became effective for all wages paid after December 31, 1977. Under CAWR, schedule A is no longer filed with employment tax forms 941 and 943 and the form W-2 was redesigned to include the Federal Insurance Contributions Act (FICA) information formerly filed on schedule A. Forms W-2 are filed with the SSA, which processes the information and supplies it to the IRS.

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By eliminating schedule A, the President's Advisory Council on Paperwork Reduction estimated an annual savings to employers of $235 million.

In 1979 an estimated 170 million forms W-2 were filed with SSA for the first time. The processed data from these forms will be used in 1980 for the underreporter programs, plus a new program that matches the forms W-2 totals with employer tax data.

Assisting the Taxpayer

The IRS provides year-round assistance through correspondence, telephone inquiries, and personal contacts, to give taxpayers information about the tax system, their rights and obligations under it, and the tax benefits available.

This year the IRS received about 96,000 written, 33 million telephone, and 8 million walk-in inquiries. More than 60 percent of these inquiries occurred from January 1 through April 27, 1979—over 19 million phone calls, more than 5 million walk-in inquiries, and over 35,000 items of correspondence, totaling over 24 million requests for assistance. A quality check of 300,000 telephone responses and returns prepared by IRS assistants during the filing period indicated an overall national accuracy rate of almost 97 percent.

Toll-free telephone assistance

With the toll-free telephone system, taxpayers anywhere in the United States can call IRS numbers listed in the tax form packages without paying a long-distance charge. Over 97 percent—18.7 million—of the telephone calls received during the 1979 tax return filing period were on the toll-free system.

Teletypewriter equipment with a nationwide toll-free number, except for Alaska and Hawaii, gives hearing-impaired taxpayers access to telephone assistance.

Walk-in service

Walk-in taxpayer assistance was offered in the inner city, business districts, and suburban and rural areas at 710 permanent offices and at 147 temporary offices set up for the filing period. In addition, over 35,000 banks and Postal Service locations helped distribute more than 273 million tax forms and instructions.

When possible, hours of service at IRS offices were extended for taxpayers who could not call or visit during normal business hours. Based on a General Accounting Office survey taken in January and February, most taxpayers had to wait less than half an hour and approximately 80 percent waited less than 15 minutes for assistance.

The IRS provided foreign language assistance at 218 of its 857 taxpayer service offices where Spanish assistance was offered by 582 employees, and other foreign language assistance by 446 employees. Bilingual taxpayer assistance also was provided through a special form that translated from Spanish, French, Portuguese, Chinese, and Vietnamese into English the information necessary for IRS employees to prepare returns.

Educating taxpayers

For the past several years, the IRS has sponsored programs to inform the public about the tax system. Programs are also available to train volunteers who assist others in preparing returns.

The IRS sponsored classes for over 39,000 individuals and small business owners. More than 5 million student publications were provided free to high

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schools and colleges through the "Understanding Taxes" and "Fundamentals of Tax Preparation" programs. IRS employees have met with high school officials throughout the country to encourage the use of "Understanding Taxes," particularly in consumer awareness classes.

Through the volunteer income tax assistance (VITA) program, the IRS recruits, trains, and supports volunteers who offer free tax assistance to low-income, elderly, military, and non-English-speaking taxpayers. Approximately 41,000 volunteers participated this year and more than 300,000 Federal income tax returns were prepared.

Simplifying the forms

The GAO suggested that the IRS establish a high-level task force to improve its forms. A task force was set up under the direction of the Commissioner, Deputy Commissioner, and four Assistant Commissioners, and the IRS has awarded a contract to revise and test forms 1040, 1040A, and related schedules to further simplify them as mandated by the Revenue Act of 1978.

Volunteers in Pittsburgh, Indianapolis, and St. Paul tested the 1979 individual income tax forms and related schedules. These volunteers—of different income levels, educational backgrounds, ages, and occupations—were recruited through radio, television, newspaper announcements, and organizations such as the Chamber of Commerce, League of Women Voters, and senior citizens groups. The IRS adopted many suggestions and recommendations for improvement in the forms and instructions. For the first time computerized readability studies were used to identify portions of the instructions for tax forms that could be made easier to read.

Publications

The IRS distributed many taxpayer information publications free of charge including 3.1 million copies of Your Federal Income Tax, 1.4 million copies of Tax Guide for Small Business, 840,000 copies of Farmer's Tax Guide, and 126,000 copies of Tax Guide for Commercial Fishermen. Additional tax materials were furnished to more than 7.5 million individual taxpayers, 625,000 tax practitioners, and 560,000 employers. The IRS also publishes more than 80 booklets—3 in Spanish—on specific tax topics.

Informing taxpayers

The National Office issued 125 news releases and answered over 3,500 media inquiries. The three major television networks and radio and television stations, movie theaters, daily and weekly newspapers, magazines, and specialized publications received taxpayer information materials.

The specialized media program provides tax information to the public through publications issued by trade, professional, service, and fraternal organizations. The IRS had the assistance of Federal agencies such as the Small Business Administration and the Office of Minority Business Enterprise. The earned income credit, IRS assistance for the hearing impaired, taxpayer education, and small business programs were publicized through specialized media.

IRS employees participated in a "Tax Clinic" broadcast over public television stations in 38 States during which viewers could call their local IRS offices for answers to tax questions.

Three half-hour IRS films provided information on the American tax system, examination and appeal rights, and the tax responsibilities of running

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a small business. These films, two of which were also released in Spanish, appeared on TV across the Nation, and before trade, civic, educational, and other groups.

With the continued cooperation of the Departments of Health, Education, and Welfare, Agriculture, and Labor, the IRS provided information to persons considered eligible for the earned income credit. Additionally, the IRS sent notices to individuals who didn't claim the credit although they appeared to be qualified according to their tax return information. As a result of the notices, 380,000 additional taxpayers received the earned income credit.

Resolving problems

The IRS problem resolution program attempts to resolve taxpayers' complaints not satisfied through regular channels. Each IRS district has a problem resolution officer who, as a member of the director's staff, is independent from the operating divisions. The most common types of problems handled are complaints about not receiving refunds and about bills in error. During 1979, the program helped resolve approximately 72,000 taxpayer problems.

Making information available

During 1978, disclosure officers and specialists processed 7,580 requests for access to records under the Freedom of Information Act in district offices and service centers. Of the requests requiring extensive search and analysis, 4,264 were granted in full and 1,016 were granted in part, and 382 were denied in full. The balance consisted of imperfect requests, cases in which records did not exist, and cases appealed before a determination could be made. The National Office Freedom of Information reading room serviced about 25,000 requests to copy or inspect records. This level of service, which is a 45-percent increase over last year, was due primarily to the release of private letter rulings edited to protect the identity of taxpayers to whom they were originally issued.

Under the Privacy Act of 1974, individuals made 510 requests for access to records about themselves and 19 requests to amend or correct these records. The IRS permitted full access in 355 of these requests and 83 were granted partial access.

This year 4,648 disclosures of tax information were made to the Department of Justice, 132,213 to child support enforcement agencies, and approximately 73 million to State tax agencies.

By law the IRS must maintain the confidentiality of tax returns and return information. This year the IRS developed security guidelines for Federal agencies and improved recordkeeping and reporting requirements for the disclosure of tax information.

The exchange of confidential information with States is intended to increase tax revenues, reduce duplicate audits, and increase taxpayer compliance. Federal tax information received by the States may be disclosed only to State agencies charged with administering State tax laws and only upon the request of the head of that agency. Disclosure officers annually visit each State tax agency to check on procedures used to safeguard return information. The IRS enters into an agreement with States that identify the types of information to be regularly exchanged and limits the exchanged information to that needed. There are now 93 Federal-State agreements in effect.

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Helping other countries

In 1963 the IRS in cooperation with the Agency for International Development began a program to assist foreign governments in modernizing their tax administration systems. Since the program started, almost 5,350 visitors from 130 countries have visited the IRS for orientation and observation programs, and this year 342 officials from 59 countries participated. IRS advisers have been assigned to 37 countries, the Caribbean Community, and the Central American Secretariat for Economic Integration.

This year long-term assistance programs were initiated in Egypt, El Salvador, and Sierra Leone, with continuing programs in Liberia, the Northern Mariana Islands, and the Trust Territory of the Pacific Islands. Special short-term assistance was provided to Jordan. There were frequent visits between Canadian National Revenue and IRS officials to discuss compliance, management, and other topics of mutual interest.

The IRS participated in the 26-member-country Inter-American Center of Tax Administrators (CIAT) 13th general assembly in Quito, Ecuador, in May 1979 where the Deputy Commissioner made a presentation on "How to Measure the Effectiveness of Tax Administration." In February 1979 the Assistant Commissioner for Taxpayer Service and Returns Processing presented a paper, "Safeguarding ADP Files and Protecting Taxpayer Privacy," at the CIAT ADP conference held in Mexico City. Through CIAT the IRS has helped the Government of Trinidad and Tobago conduct an ADP feasibility study. The Commissioner will serve as a member of the CIAT Executive Council for fiscal 1980.

Enforcing the Law

Examinations

The IRS examines returns to help ensure a high degree of voluntary compliance. The discriminant function (DIF) system is the primary method used to select individual returns for examination using mathematical formulas for each class of return to measure the probability of error. Returns selected by DIF are screened manually and those having the highest potential of error are assigned for examination.

Returns may also be selected at random for examination under the taxpayer compliance measurement program (TCMP), resulting in a statistical sampling of all classes of individual returns. Examinations under this program are more intensive because the results are used to develop measurements of compliance and to update DIF formulas. Compliance measurement is an important factor in determining examination coverage of different classes of taxpayers.

Some returns are selected through manual review or because of a related examination. For example, if the IRS examines a partnership return the returns of partners may be audited. Returns of shareholders and executives may be examined with the audit of their corporation. Other returns may be selected based on information documents filed by payers of wages, dividends, and interest. The IRS also screens returns with adjusted gross income above certain levels and amended returns of taxpayers.

Tax return classes.—During 1978, the IRS conducted a study to determine whether the class structure using adjusted gross income to group individual returns could be improved. Classes are used for DIF scoring, planning workload and staffing, and monitoring results of examinations. The study group recommended new classes to group returns for better use of IRS examination resources. Total positive income will be used to class nonbu-

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siness returns and total gross receipts to class business returns beginning with the 1979 individual returns filed in 1980.

Classification.—The classification program includes the manual screening of DIF returns and the classification of other returns to identify for examination those returns having the highest potential of error. In 1979 the IRS approved centralized classification at the service centers instead of in district offices. This change will be implemented at all service centers by the end of 1980.

Examination results

The IRS examined 2,273,603 tax returns of all types in 1979. Of those 199,907 returns were examined in service centers, compared with 169,390 last year, an increase of 18 percent. The remainder were examined in district offices by revenue agents and tax auditors.

Revenue agents examined 679,302 returns at the taxpayer's residence or place of business, a decrease of 48,951 returns, or 7 percent, from last year. Tax auditors examined 1,394,394 under office audit procedures, a decrease of 36,775 returns, or 2 percent, from last year.

Examination coverage of income and estate and gift tax returns was 2.24 percent compared with 2.29 percent in 1978.

The IRS examination program resulted in $7.2 billion in recommended additional tax and penalties, of which individual returns accounted for $2 billion, fiduciary returns for $104.9 million, corporate returns for $4.2 billion, and estate and gift tax returns, $683 million. The examination of employment and excise tax returns resulted in the remaining $158 million.

IRS examinations also disclosed overassessments on 133,059 returns, resulting in refunds of $328 million compared with 132,600 returns with refunds of $312 million last year.

Service center program

The IRS service center examination and correction program is limited generally to the resolution or verification of issues that can be handled through correspondence with the taxpayer. In 1979, 696,341 returns were examined or corrected compared with 663,173 in 1978, a 5-percent increase.

Coordinated examination program

The coordinated examination program covers financial institutions and utilities whose gross assets exceed $1 billion and other corporations if their gross assets exceed $250 million.

Since coordinated examinations involve complex accounting systems, the IRS uses teams of revenue agents, economists, computer specialists, engineer agents, international and excise tax examiners, and employee plan specialists. At the end of the year, over 1,300 corporations were in this program.

Computer-assisted examinations

Computer programs reduce the cost of investigations, examinations, and compliance projects since computer procedures take a fraction of the time to do the same job manually.

The IRS has a staff of about 150 audit specialists trained in computer systems, hardware, program languages, and examination techniques.

Subterranean economy

The "subterranean economy" is a term used to identify unreported taxable income resulting from legal and illegal transactions. In 1979, a Commission-

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er's task force report indicated that in 1976, individuals failed to report income of $75 to $100 billion from legal sources and $25 to $35 billion from illegal sources.

The IRS is already engaged in a number of compliance programs involving the subterranean economy. For example, the IRS matches information documents with tax returns to identify nonfilers and underreporters and also initiates investigations of persons who filed previously but have stopped filing.

As a result of the task force's report, the IRS is establishing new programs and allocating resources to coordinated projects to discover and tax unreported income. The results of these projects will be considered in the future selection of returns for examination.

Tax shelters

In recent years many promoters have used artificial transactions and questionable legal interpretations in marketing limited partnership syndications to high-income taxpayers, creating large tax deductions and losses that lack economic reality. In 1973 the IRS began a tax shelter audit program in the oil and gas industry, later expanding to other potentially abusive shelter areas. Efforts have included identifying tax shelter cases, educating agents to recognize tax shelter issues, developing the IRS position on key issues, and identifying cases for early litigation.

This year the IRS has emphasized that certain tax benefits received by tax shelter participants are properly included in income in later years.

Audit coverage of all partnership returns was 2.5 percent for 1979 with 17 percent coverage for partnership returns in the over-$25,000 loss category. The use of computer programs to analyze, identify, and retain data on partners and partnerships, coupled with information obtained from the Securities and Exchange Commission and State agencies, improves the IRS capability to identify partnership returns that warrant examination.

Returns preparers

Under the Tax Reform Act of 1976, the IRS has been provided with a means to regulate standards of conduct as well as disclosure and reporting rules for returns preparers. Penalties ranging from $25 to $500 are provided for noncompliance with the laws and regulations.

In 1979, over $1 million in penalties have been proposed by district offices against 3,519 preparers.

Quality control

The Quality Control Staff, through review of completed work, attempts to assure fair and impartial administration of the revenue laws by examiners. The staff also advises management of areas requiring attention and takes action to maintain high quality examination standards. The IRS is currently defining quality examination in more measurable terms and developing new instructions for monitoring quality, to further improve examinations.

Simultaneous examination

The IRS simultaneous examination program with treaty countries originated with Canada in 1977 and was expanded to the United Kingdom in 1978 and the German Federal Republic and France this year. In this program, the participating governments separately examine multinational taxpayers under their respective jurisdictions. Before an audit begins representatives of each

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country meet to plan and coordinate the examination, and information is exchanged during each stage of the examination, in accordance with the tax treaty provisions.

International enforcement program

Examiners with expertise in international issues audit returns containing those issues, the majority of which are multinational corporations included in the simultaneous examination program. International examiners are trained to handle complex issues involving controlled foreign corporations, transfers of property to corporations, allocation of income among taxpayers, foreign tax credit, and the international boycott provisions of the Tax Reform Act of 1976.

Enrolled agents

Individuals who are not attorneys or certified public accountants must pass the special enrollment examination in order to represent taxpayers before the IRS. The examination focuses on the tasks enrolled agents must perform and emphasizes Federal tax laws as they apply to business operations, sole proprietorships, partnerships, and corporations. The current examination is divided into four parts and candidates are required to pass each part though they may retain credit for any part passed and need only retake those parts failed. They must, however, pass the entire examination within 2 consecutive years.

Treasury Department Circular 230, "Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries," was amended in 1979, to expand the advertising and solicitation provisions of the regulations. Enrolled agents may now advertise certain background and fee information.

This year 4,332 candidates took the special enrollment examination compared with 4,380 in 1978.

Appeals

The IRS encourages the resolution of tax disputes through an administrative appeals system rather than litigation. The appeals system, administered by the Office of the Regional Director of Appeals in each of seven regions, is designed to minimize inconvenience, expense, and delay to taxpayers in resolving contested tax cases.

Taxpayers who disagree with proposed changes in tax liability are entitled to a prompt, independent review. Proceedings in the appeals process are informal so taxpayers may, and frequently do, represent themselves. In addition, in all office examination cases and in field examination cases where the disputed tax liability for each taxable year involves $2,500 or less, taxpayers may obtain a conference without filing a written protest.

If a tax dispute cannot be resolved at the administrative appeals level, taxpayers have additional appeals rights to the courts. If the disputed tax does not exceed $5,000 in any tax year, a simple procedure is available under the U.S. Tax Court small-case procedures that permits informal hearings where taxpayers may present their cases before a special trial judge. However, neither the taxpayer nor the Government may appeal decisions in such cases.

If the disputed tax exceeds $5,000 or if the taxpayer chooses, the case may be heard under regular Tax Court procedures. Taxpayers may choose to bypass the Tax Court by paying the tax deficiency and filing a claim for refund within 2 years from the date of payment

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If the claim is denied or no action is taken by the IRS within 6 months, the taxpayer may file suit for a refund in either a U.S. district court or the Court of Claims. Adverse decisions of the Tax Court or the district court may be appealed to the U.S. Circuit Court of Appeals having jurisdiction. Adverse decisions of the Court of Claims and the Circuit Courts of Appeals may be appealed to the U.S. Supreme Court.

Cases considered by the Appeals Office fall into two categories: nondocketed and docketed. Nondocketed cases are those in which a taxpayer is protesting a proposed action by an IRS District or Service Center Director involving additional taxes and/or penalties, a refund disallowance, or a rejection of an offer in compromise. Docketed cases are those in which taxpayers have filed a petitioner with the U.S. Tax Court. During this year, 21 percent of Appeals receipts consisted of docketed cases and 79 percent nondocketed.

This year reflects the most significant changes to the IRS administrative appeals process in many years. On October 2, 1978, the IRS commenced operating under a single level of appeal. In addition to the cases previously under the jurisdiction of Appeals and the former district conference, the appeals function now has increased responsibility for past assessment penalty and employee plans and exempt organization appeals. This was also the first full year of operation under Revenue Procedure 78-9 where Appeals now has exclusive jurisdiction of docketed cases for a period of 4 months with the possibility of extensions if a case is in the process of being settled.

Upon the implementation of a single level of appeal, there were approximately 11,500 work units in the district conference inventory for which Appeals assumed responsibility. Within 6 months Appeals disposed of 93 percent of this inventory. The total inventory of the administrative appeals process remained relatively level at year's end—there were 35,000 work units in inventory compared with 32,700 at the end of 1978.

The overall agreement rate for nondocketed work units increased from 84 percent in 1978 to 85 percent in 1979. The docketed agreement rate in 1979 for Appeals and District Counsel combined was maintained at the 73-percent level of 1978, prior to Revenue Procedure 78-9. For Appeals, under Revenue Procedure 78-9, the agreement rate was 52 percent with 70 percent of the cases settled within 4 months.

In 1978 the Appeals district conference function disposed of 54,000 work units with 960 appeals officers and district conferees. In 1979 the administrative appeals process disposed of 46,500 work units with 130 fewer appeals officers than the previous year's combined total of appeals officers and district conferees. The disposal rate in 1979 was 55 work units per appeals officer. In 1978 the former Appellate Division averaged 43 work unit disposals per appeals officer and the combined disposal rate for appeals officers and district conferees in 1978 was 56 work units. In addition to these work units, the Appeals Division disposed of 7,200 post assessment penalty appeal protests representing $12 million in 1979.

Criminal investigation

The Criminal Investigation Division is responsible for the enforcement of the criminal provisions of the tax laws. The Division's enforcement activities are divided into "general enforcement" and "special enforcement" programs.

The general enforcement program provides for balanced criminal tax enforcement and geographical and occupational coverage of the population involving various types of alleged violations of the tax laws. In recent years,

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added enforcement efforts have been put on the questionable refund program and the illegal tax protester project.

The special enforcement program covers the identification and investigation of individuals who derive substantial income from illegal activities and violate the tax laws. Criminal Investigation participates in the Federal strike force program against organized crime with strike force units located in 13 major cities coordinated by attorneys from the Justice Department. The special enforcement program also includes the high-level narcotics financiers and traffickers project, coordinated with the Drug Enforcement Administration, wagering, and other efforts against racketeers. During 1979, the Division completed 1,533 investigations in the special enforcement program and recommended prosecution in 685 cases. There were 306 convictions or pleas of guilty to tax charges and 832 prosecutions pending on September 30, 1979.

Some 9,780 investigations were initiated in the general and special enforcement programs, up from 9,481 the previous year. The Division completed 8,952 investigations and recommended prosecution in 3,338 investigations. Grand juries indicted or U.S. attorneys filed information on 1,820 taxpayers. Prosecution was successfully completed in 1,612 cases. Taxpayers entered guilty pleas in 1,152 cases, 118 pleaded nolo contendere, and 342 were convicted after trial. Acquittals and dismissals totaled 86 and 183, respectively. Of the 1,519 taxpayers sentenced during the year, 675, or 44.4 percent, received jail sentences.

Collection

The Collection Division is responsible for collecting taxes due but not paid, securing delinquent tax returns and payments, and preventing delinquency in the filing and payment of taxes. During 1979, the Division disposed of 2.1 million delinquent accounts. Some $3.3 billion were collected from delinquent accounts and $1.6 billion were collected from notices. Approximately 1.3 million delinquent returns were secured, involving $1.4 billion in additional assessments.

Over the past year several significant steps were taken to improve programs to fulfill the Collection mission. For example, it was determined that some work previously performed in the district offices could be more efficiently done in the service centers, frequently replacing expensive field investigations. A new service center collection function initiates correspondence and telephone contacts with taxpayers to resolve balance due and return delinquency conditions. If a taxpayer is unable to make immediate payment, the service center will, under certain circumstances, make arrangements with the taxpayer to pay the amount due in equal monthly installments. The taxpayer must comply with certain conditions such as timely payment of future taxes and filing current returns. Cases that cannot be resolved in the service center are sent to the various district offices for further action.

A collection activity of office and field functions is located in all 58 IRS district offices. Most cases sent to the districts are initially processed in the office function, where correspondence and telephone contacts are made. Taxpayers may also come to the district office to discuss their case with an IRS representative. Cases that cannot be resolved in the office function are sent to the field function where revenue officers and revenue representatives personally contact taxpayers to collect delinquent taxes and secure delinquent returns.

Federal tax laws provide the IRS with broad authorities to collect delinquent taxes. Among these are the filing of a Notice of Federal Tax Lien

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and 371,000 were filed in 1979; levy authority for wages, salaries, etc., and 465,000 were served in 1979; and the seizure of both real and personal property, with 5,723 made in 1979.

Trust fund taxes

Nonpayment of taxes withheld from employees' wages is one of the most serious delinquency problems. The IRS identifies employment tax delinquencies through various programs and closely monitors employers who fail to comply with the deposit, filing, and payment requirements. The Federal tax deposit alert program identifies taxpayers who are required to deposit taxes withheld from their employees' wages but do not make these deposits. These taxpayers are contacted by revenue officers who take appropriate action. If further followup is necessary, taxpayers are monitored under the trust fund compliance program. Such taxpayers may be required to file monthly, rather than quarterly, returns. Some may also be required to deposit withheld taxes into special bank accounts in trust for the United States. Violations can lead to criminal prosecution.

Information returns program

The Collection Division is refining its program to better identify nonfilers of individual income tax returns by developing a predictive model that will use discriminant analysis to identify those characteristics that best predict that people selected for investigation are required to file returns. This will mean that the IRS will use resources on productive investigations, while individuals who are not required to file will not be contacted needlessly.

The Division is also attempting to improve the overall individual return filing delinquency program by identifying and contacting most delinquent taxpayers within 6 months after the return due date. Also, to better inform individuals about filing requirements, the IRS will provide a document containing basic filing criteria with return delinquency notices mailed to taxpayers.

Returns compliance

Returns compliance programs identify potential nonfilers who are then contacted to attempt to ensure that all returns due are secured. In 1979, returns compliance programs resulted in 76,968 returns secured with additional taxes assessed of $20.5 million.

The Collection Division is currently developing programs to identify nonfilers who are included in the subterranean economy to help to improve total compliance and reduce the size of the "compliance gap."

Child support obligations

As a result of the Social Services Amendment of 1974, Internal Revenue Code section 6305 empowers the IRS to collect delinquent child support payments on behalf of certain State agencies.

IRS collection may be used only for cases in which a court-ordered child-support obligation is delinquent and an assignment of support rights has been executed as a condition of eligibility for Aid to Families with Dependent Children.

After State collection resources have been exhausted, applications are made through the HEW Office of Child Support Enforcement for IRS collection assistance. Once referred to the IRS, delinquent child support accounts are collected the same as delinquent taxes.

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Offers in compromise

Since 1831 the Treasury has been authorized to compromise liabilities owed to the United States. This authority is currently vested in the Secretary of the Treasury. The offer-in-compromise procedure is used as a tool to effect maximum collection in situations where the liability is not collectible in full or there is substantial doubt as to the correctness of the liability. In 1979 the Collection Division processed 2,016 offers in compromise.

International operations

The Office of International Operations (OIO) is responsible for making certain that U.S. citizens residing in foreign countries and foreign entities doing business in the United States comply with Federal tax laws. It is also concerned with U.S. businesses controlled by foreign interests and assists in the overseas examination of multinational corporations. Further, OIO assists the U.S. Competent Authority in the administration of tax treaties. OIO also administers the social security laws in the U.S. possessions and Puerto Rico and the income tax laws affecting Puerto Rican residents with income from sources outside of Puerto Rico.

OIO maintains a network of 14 foreign posts managed by revenue service representatives who provide the principal contact between the IRS and Americans living abroad. These offices have multicountry responsibility, except in Canada, and are located in American population centers to assure maximum impact on taxpayer compliance and convenient access for American citizens to obtain tax assistance.

OIO's posts in Bonn, London, Paris, and Rome cover Western Europe and North Africa. The post in Johannesburg services Africa, south of the Sahara. The Mexico City, Caracas, and Sao Paulo posts are assigned Mexico, Central America, and South America, while the Ottawa post handles Canada. The offices in Tokyo, Manila, Singapore, and Sydney carry out tax administrative activities in Japan, Southeast Asia, Australia, and New Zealand. The post in Tehran has been temporarily closed.

The revenue service representatives maintain personal contacts with foreign tax authorities, foreign government officials, the Department of State and other U.S. agencies, as well as American communities abroad. They also serve as a liaison with foreign competent authorities, in tax treaty matters, for the U.S. Competent Authority.

Examination, collection, and criminal investigation activities take place primarily in the United States, even though OIO sends revenue agents, tax auditors, and criminal investigators abroad to conduct investigations. Collection cases that cannot be settled through correspondence are sent to the foreign posts for personal contact by the service representatives or by the revenue officers assigned to the posts.

Taxpayers have received tax assistance abroad for 26 years and this year 21 assistants were sent abroad to 150 cities in 92 foreign countries. More than 150,000 taxpayers were assisted and several hundred members of the armed forces attended 7 military tax schools. The armed forces participants then helped thousands of military personnel prepare their own tax returns.

Treaties

Tax treaties with other countries eliminate double taxation, remove tax barriers to trade and investment, and help curb tax avoidance. The United States now has income tax treaties with 38 countries and estate tax treaties with 13 countries.

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In 1979, meetings were held with tax officials from several treaty countries to improve the administration of the treaties involved. These conferences improved working arrangements for more effective exchange of information, for resolution of recurring problems that arise from conflict of U.S. and foreign tax laws, and for elimination of double taxation.

This year the IRS and the Puerto Rican Department of the Treasury established a mutual agreement procedure to resolve double taxation cases with Puerto Rico. The IRS has entered into a tax administration agreement with Puerto Rico, American Samoa, Guam, and the Virgin Islands that provides for the exchange of taxpayer return information and the development of mutual assistance programs.

Some tax treaties provide for mutual collection assistance and OIO is playing an increasing role on a reciprocal basis in collecting taxes of these treaty partners from aliens in the United States.

Employee plans and exempt organizations

The Office of Employee Plans and Exempt Organizations (EP/EO) administers the regulatory responsibilities of the IRS for employee benefit plans and tax-exempt organizations. In the National Office these functions are handled by the Employee Plans, Exempt Organizations, and Actuarial Divisions. EP/EO field staffs are located primarily in the 7 regional IRS offices and 19 key districts.

The Employee Plans activity administers the Employee Retirement Income Security Act (ERISA) of 1974 with emphasis on processing determination and notification letter requests timely and providing uniform interpretation of the appropriate laws and procedures. The IRS continues to coordinate the administration of ERISA with the Department of Labor and the Pension Benefit Guaranty Corporation.

Since the ERISA requalification determination letter inventory decreased, focus was directed to a field compliance examination program to ensure that employee plans are operating in accordance with the plan document and that the rights and benefits of all plan participants are protected. Followup continues on those plans that received determination letters before the enactment of ERISA but failed to request a determination letter to conform to ERISA's requirements. Those plans that reported a minimum funding deficiency on form 5500 series returns are being notified of the requirements for filing Form 5330, Return of Initial Excise Taxes Related to Pension and Profit-Sharing Plans.

Revenue Procedure 79-28, issued April 27, 1979, gives simplified instructions to employers, law firms, and sponsors of plans who submit requests for determination or notification letters designed to conform the plan to final regulations under ERISA. As a result, adopters of approved master and prototype plans, field prototype plans, pattern plans, and basic plans need no longer submit for IRS approval amendments made only to conform plans to final regulations.

An expanded revenue ruling program for Employee Plans was implemented during 1979 to identify all pre-ERISA revenue rulings that were invalid or misleading under present law. Revenue rulings are being prepared to revoke, obsolete, restate, or modify those in need of updating.

The Revenue Act of 1978 provided for simplified employee pensions for calendar years beginning after December 31, 1978. The IRS has been involved in issuing instructions and developing a model agreement for use by the public.

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During the year, 5 regulations, and 22 revenue rulings and procedures were issued, as well as 2,235 National Office opinion letters on master and prototype plans dealing with Keogh plans, corporate plans, and individual retirement accounts and annuities.

The IRS devoted an average of 751 field professional positions to carry out employee plan responsibilities. Advance determination letters were issued on the qualification of pension, profit-sharing, and other employee benefit plans. Examinations were conducted to determine the qualification of plans in operation and to verify plan contribution deductions. During the year, 141,263 determination letters were issued on corporate and self-employed plans for a decrease of 34 percent from 1978.

The Exempt Organizations activity determines the qualifications of organizations seeking tax-exempt recognition, determines their private foundation status, and examines returns to ensure compliance with the law. The number of active entities on the Exempt Organizations master file increased from 810,048 in 1978 to 824,536 in 1979.

This year, 7 regulations, 25 revenue rulings and procedures, 340 technical advice memoranda, and 21 announcements were issued or revised. An average of 433 field professional positions were used to examine 22,371 exempt organization returns. Also, 114 field professional positions and 117 National Office technical positions were used for 50,568 applications, reapplications, and requests for rulings on proposed transactions from organizations seeking a determination of tax-exempt status or of the effect of organizational or operational changes on their status. The development of the new formulas to select certain exempt organization returns for examination has been completed, using the taxpayer compliance measurement program (TCMP) file augmented by the master file data. The result was improved formulas for selection of Internal Revenue Code subsection 501(c)(3) public charities and 501(c)(4) organizations for examination.

The IRS is developing a TCMP survey for all Internal Revenue Code 501(c) through 501(c)8 subsections having more than 5,000 filers. The survey, involving examinations of 20,000 returns filed in 1980 through 1983, will begin in October 1980.

Additional guidelines have been published providing instructions and procedures to examiners for the preexamination of churches and related organizations. Guidelines were also issued providing uniform procedures for the identification, investigation, and examination of religious organizations employing questionable claims of tax-exempt church status.

In 1979, the IRS concluded a nationwide review of the exempt status under Internal Revenue Code 501(c)(4) and 501(c)(7) of certain homeowners associations. The IRS advised the homeowners associations revoked under the program of the availability of exempt status under section 528. The program resulted in 532 revocations under 501(c)(4) and 501(c)(7) and 479 conversions to section 528 status.

Managing the System

Planning and research

During 1979, the IRS prepared a 5-year plan for resource needs as well as a plan for significant issues confronting tax administration. Major research was done on taxpayer opinions, ways to simplify Federal tax reporting, tax compliance, and improvements to the structure and operations of the IRS. Testimony and other information were developed for presentation to

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congressional committees, pending legislation was analyzed, and statistical and other analyses were carried out.

Research efforts

A nationwide survey of taxpayers was conducted to determine satisfaction with IRS services and to get public opinion on tax law enforcement. The results of the survey will be available in early 1980.

A study of the unlawful use of tax havens has been established to examine interagency coordination, domestic and foreign information, reporting requirements, regulations, enforcement resources, and existing law.

In 1978 the IRS began a series of studies to determine compliance with some of the approximately 90 provisions in the Internal Revenue Code that allow taxpayers to defer certain tax consequences to subsequent years. Since the problems associated with tax deferrals involve all types of taxpayers, the studies deal with corporate, partnership, estate, trust, and individual tax returns. Each study will develop data concerning tax consequences and compliance with the various deferral provisions. Some studies involve partnership tax shelter losses in excess of at-risk basis, deferred gains on sales of personal residences, stock basis reduced by nontaxable distributions, special estate tax valuations, and the recapture of the new residence purchase credit if the residence is sold within 3 years of purchase. The IRS also plans to study deferred gains on installment sales, changes in accounting methods, recapture of accelerated depreciation on certain housing projects, and at-risk limitations of losses from various business activities.

A study of compliance by workers claiming independent contractor status was completed, resulting in a legislative proposal to require tax withholding on nonemployee compensation.

Research was undertaken on the effectiveness of the information reporting system. The studies focus on how well payers comply with information reporting requirements and the use of information documents in enforcement programs, as well as the feasibility of requiring information reporting on bearer instruments.

A major research report, "Estimates of Income Unreported on Individual Income Tax Returns," issued in 1979, presents estimates of total income individuals should have reported to the IRS but did not and the associated tax revenue loss. The estimates include underreporting on individual returns filed and on returns that should have been filed covering legal and selected types of illegal income. Copies of the report, Publication 1104, are for sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Recent legislation required the Secretary of the Treasury to study existing highway excise tax structure and alternative tax funding methods for the highway trust fund. As a part of the study the IRS will examine the administrative and compliance aspects. Treasury's final report to Congress is due April 1982.

This year the IRS completed a study of the civil penalties in the tax law after examining approximately 75 different penalties for not filing tax returns and information documents, not paying taxes timely, and not reporting Federal tax liability properly. The report recommends approximately 35 legislative changes and several administrative changes to deter noncompliance and to improve the administration of penalty provisions.

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Taxpayer compliance measurement

The taxpayer compliance measurement program is the IRS basic research effort to estimate the nature and extent of tax law compliance. Random samples of returns filed in different tax areas are examined to develop data used to plan enforcement programs and to improve computer selection of returns for examination.

This year the IRS completed field examinations of a sample survey of 1976 individual returns and undertook a project to determine how well TCMP examinations disclose income covered by information return reporting. Examinations continued on the third survey of corporations with assets up to $10 million and the process for selecting returns for the first TCMP survey of employee benefit plans was started.

The IRS also intends to develop a predictive model of nonfilers to better select these cases for collection action. This model will provide a scientific scoring similar to the discriminant function system used to detect unreported tax liabilities. This study will be the first TCMP survey in the individual nonfiler area to estimate the size and analyze the characteristics of the nonfiler population.

Productivity

This year, the IRS established a fund to sponsor studies and tests of ideas to increase productivity. The IRS also established a program to encourage cost savings so that managers who institute them can keep 50 percent of the savings in their financial play for a 1-year period. The IRS identified steps that should save about $21 million when fully operational. For example, filing requirements were modified for employers maintaining corporate pension plans with fewer than 100 employees so that a full return need only be filed once every 3 years, with a short registration form other years.

Publishing statistics

The annual Statistics of Income (SOI) publications provide a variety of data reported on tax returns without violating taxpayer rights to privacy.

SOI publications issued in 1979 included preliminary reports for individual income tax returns for 1977 and corporations and unincorporated business returns for 1976, final reports for individuals for 1976, unincorporated businesses for 1975, and corporations for 1974.

This year an SOI report on estate tax returns filed in 1976 was completed. These data are compiled every 4 years. A sample of the 1976 returns provided the basis for a study to show the relationships of wealth and income of decedents and their heirs as reported on income tax returns. This year the IRS provided the first SOI supplemental report in several years giving information by country on foreign income and taxes of U.S. corporations claiming a foreign tax credit.

SOI publications may be purchased from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Tax models

Tax models are used primarily to respond to requests for tabulations of tax return data. Five basic models cover individuals, corporations, sole proprietorships, partnerships, and estates and consist of computer programs used with special SOI files of the most current data.

Under the Federal-State exchange program, State governments can obtain copies of the individual income tax model file for tax administration purposes.

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The same file, with all taxpayer identifying information removed, can also be purchased by the public from the National Archives. The public may also obtain a companion file resulting from a special study on the sales of capital assets by individuals.

Projecting returns filed

For planning and budgeting purposes, nationwide projections are made of the number of returns to be filed and IRS workload. Annual updates incorporate economic and demographic changes and the effects of tax law changes and filing patterns.

The number of primary returns is expected to grow from 130 million in 1978 to 164 million in 1990. This increase of 26.3 percent reflects the expected growth in population and economic activity.

Legislative activities

The IRS analyzes legislative proposals affecting it and determines the administrative implications. Once legislation is enacted, a plan for implementing each provision is coordinated with appropriate IRS offices to assure that all provisions are implemented. During the year, 17 implementation plans were developed, including major 1978 legislation such as the Energy Tax Act, the Foreign Earned Income Act, and the Revenue Act. The Revenue Act alone required more than 500 separate actions to implement the more than 250 changes in the tax law.

Labor-management relations

The National Treasury Employees Union and the IRS have agreed to negotiate 1 master labor agreement to cover the approximately 70,000 IRS employees represented by the union. Details of the agreement have not been finalized.

A 13-day labor relations course is being given in regional offices to provide technical skills to field office personnel to carry out contract administration. The course emphasizes settlement of grievances and unfair labor practices at the lowest possible level.

The IRS publishes The Labor Relations Report, a biweekly newsletter for executives and personnel staffs, highlighting developments likely to impact on the overall management of the IRS. It also provides personnel staffs specialized information needed in day-to-day contract administration and dealing with a union.

Paraprofessional positions

Several paraprofessional occupations have been established in the IRS to perform lower graded, less complex work formerly done by higher graded professional and technical employees. This has provided new avenues of employment for persons with less than the full range of professional or technical qualifications and established a bridge to let clerical and other lower graded employees have the opportunity to advance to professional and technical occupations. During 1979, the IRS placed almost 3,000 employees in paraprofessional positions. This provided increased upward mobility opportunities and resulted in saving several million dollars over the cost of a similar number of professional and technical positions.

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Awards for incentive

Many employees received recognition for their outstanding contributions under the IRS incentive awards program. They included Meritorious Service Award, 11 Commissioner's Awards, 29 Special Achievement Awards of $1,000 or more, and 3 special recognition awards for exposing bribery schemes. Also, William E. Mulroy received the 1979 Association of Federal Investigators Enforcement Award. And 50 employees received Presidential Letters of Recognition for employee contributions resulting in benefits of $5,000 or more or for exceptional achievement in specific programs.

Under the incentive awards program, 7,727 persons were recognized and the IRS realized about $1,869,000 in benefits during 1979.

Jobs for the handicapped

The IRS hired 421 severely handicapped employees this year, increasing this part of the work force to 2,122. There are now 490 legally blind IRS employees. Taxpayer Service has 159 blind employees, most of whom are taxpayer service representatives. Some blind representatives have moved to the taxpayer service specialist position, which offers greater advancement opportunity, and others have been promoted from taxpayer service specialist to group manager. The IRS nominee for the Outstanding Federal Handicapped Employee of the Year is Edwin Tylee of the Brookhaven Service Center.

Training

This year the IRS developed training programs to implement provisions of the Civil Service Reform Act, including a major review of all levels of management training.

During the past year, 725 men and women attended 3 training schools at the Federal Law Enforcement Training Center.

A training program has been developed to give expertise in the terminology, operations, and special accounting procedures involved in oil and gas taxation issues to senior examiners designated "petroleum industry specialists." Training for other industry specialist areas—aerospace, air transportation, chemicals, construction, data processing, insurance, pharmaceuticals, railroads, tractors and other heavy equipment, utilities, and forest products—will be developed.

Disclosure awareness training programs were developed and conducted for special agents, revenue agents, and taxpayer service employees. A disclosure orientation program has been developed for use as part of all basic training and annual refresher training courses. A disclosure officer training course was given to improve ability to deal effectively with the public in Freedom of Information and Privacy Act matters.

The bankruptcy law was completely revised by Congress late in 1978, requiring certain Collection Division and Chief Counsel personnel to be trained in a relatively short period.

Audiotapes on the rules of conduct were developed for visually handicapped employees. Tapes of various taxpayer service courses were developed for use by blind employees. A video tape that shows data transcription instructions in sign language was developed to train deaf data transcribers.

Training assistance also was provided State and local revenue agencies. For example, three employees from the New York Department of Taxation and Finance attended the IRS 2-week basic training course to prepare instructors to teach their employees.

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Two employees of the government of American Samoa attended the 12-week revenue agent basic training course. The newly appointed Tennessee Commissioner of Revenue and two assistants received a 2-day orientation at the Memphis Service Center.

Training materials were provided the Commonwealth of Puerto Rico so its revenue employees could receive an overview of the IRS special agent training curriculum. Training in computer system and auditing techniques was given three employees of the Connecticut State government. Almost 2,000 employees from various State and local governments have received training assistance in financial investigative techniques, and procedures used in investigation of white-collar crime.

In line with the President's commitment to improve the quality of public correspondence, more than 600 IRS employees attended writing workshops. Five different workshops are offered to accommodate employee needs ranging from 8 to 40 hours of classroom work and including self-study exercises.

Logistics support

To comply with Executive Order 12003, July 20, 1977, requiring a 20-percent reduction in energy use by 1985, a joint IRS/GSA task force was formed to investigate energy conservation in the IRS service centers. The task force identified potential annual savings of up to $708,000 in utility costs after surveying the Andover, Atlanta, Fresno, Memphis, and Ogden Service Centers. Implementation plans are underway to help produce a net reduction Servicewide of approximately 30 percent in the consumption of energy during 1980 in comparison with the 1975 base year.

This year the IRS awarded contracts of $1,521,000 to minority and disadvantaged owned businesses exceeding its $1 million goal by 52 percent.

Over two-thirds of the Internal Revenue Manual has been converted to a new electronic composing system. Under this system, updates to the manual can be composed, printed, and distributed in 3 to 10 workdays, less than a quarter of the time required previously.

The cost of express mail systems was reduced by approximately $300,000 through use of IRS courier service and better transportation methods. Records disposition released space and equipment valued at $5,608,000. Some 170,500 cubic feet were destroyed and more than 371,500 cubic feet were retired to Federal Records Centers.

Savings of over $800,000 were accomplished through the reduction of utilities, guard services, and rent for released space. New procedures for more economical use of the Federal telecommunications system resulted in savings of $1.3 million. An IRS household goods relocation system was introduced that increases efficiency and has saved approximately $100,000 since implemented.

The IRS experienced a rate of 3.2 disabling injuries per million staff hours worked in calendar 1978. IRS employees drove 121 million miles with an accident frequency rate of 5.5 accidents per million miles driven. Both the disabling injury and motor vehicle accident rates reflect slight reductions from 1977 and continue to be among the lowest of all Federal agencies.

Equal opportunity

The position of Assistant to the Commissioner (Equal Opportunity) was established in 1979, reflecting IRS emphasis on equal opportunity and affirmative action efforts.

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Many IRS offices this year observed special events such as Black History Week, Hispanic Heritage Week, Women in Government Month and Asian/Pacific American Week.

New program guidance was issued in an EEO handbook for IRS managers and special issuances were made on evaluation of EEO performance and EEO duties. Affirmative action plans were prepared in each office based on assessment of local needs and problems.

From July 1978 through July 1979, total full-time regular employment in the IRS showed a 1.9-percent decrease. However, during that same time, the number of women decreased 0.5 percent and the number of minorities increased 2.5 percent. Women in positions at GS–13 and above increased from 4.5 percent to 5.3 percent and minorities from 5.8 percent to 6.5 percent. There were gains in the employment of women and minorities in almost all IRS major occupations, including attorney, criminal investigator, revenue agent, and appeals officer.

National Computer Center

The National Computer Center uses eight computer systems and three computerized microfilm systems to process the individual, business, exempt organization, employee plans, and individual retirement account master files for the Nation.

The Computer Center operates 24 hours a day, 7 days a week, and maintains reciprocal accounting with each of the 10 IRS service centers. As of August 1979 the number of taxpayer accounts on the individual master file had grown to 114.2 million, a 2.9-percent increase over the same period in 1978. The business master file had 21.3 million accounts—24.1 percent above 1978. There were also 1.1 million on the exempt organization master file, 1.3 million on the employee plans master file, and 227,000 on the individual retirement account master file.

Data Center

The IRS Data Center is responsible for the performance of non-master-file data processing operations. Installation of a new computer system is scheduled for completion the last quarter of calendar 1979. The increased capacity and sophistication of this new system will enable the Data Center to replace the two existing systems, and to serve as a teleprocessing center for the IRS.

A new filming system has been installed at the Data Center to produce microfiche of 700,000 employee benefit plan returns each year. This filming system is designed to provide immediate access to copies of these returns at IRS service centers and the Department of Labor as mandated by law. This system includes one of the largest applications of full reversal processing of film from quality source documents. Full implementation early next year will result in the production of approximately 100,000 microfiche per month.

Technical activities

The IRS tax ruling program consists of letter rulings, technical advice, and published revenue rulings. This year the IRS acted on 27,489 requests for tax rulings and technical advice, and issued 450 revenue rulings and revenue procedures.

A letter ruling is a written statement issued to a taxpayer interpreting and applying tax law to a specific set of facts. Such a ruling provides guidance

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concerning the tax effects of a proposed transaction. Letter rulings are not precedents and may not be relied upon by taxpayers other than the recipient.

Technical advice is issued by the National Office at the request of a district office to provide guidance on the proper application of the tax laws to specific facts in connection with the audit of a taxpayer's return or claim for refund or credit.

A revenue ruling is an interpretation of the tax laws published in the weekly Internal Revenue Bulletin to inform and guide taxpayers, practitioners, and IRS personnel.

Foreign tax credit regulations

Proposed foreign tax credit regulations, announced in 1979, essentially confirm the position taken in revenue rulings issued in 1978 that payments to foreign oil-producing countries by U.S. producers based on artificially posted prices cannot be credited against U.S. income taxes. The proposed regulations set out guidelines of circumstances under which a payment to a foreign country may be credited against U.S. income tax liabilities. The proposed regulations were the result of an extensive review of case law, published revenue rulings, and legislative history.

LIFO inventory valuation

In response to the continuing problems of inflation, taxpayers in unprecendented numbers elected to use the last-in, first-out (LIFO) method of inventory valuation as a permissible means of sheltering their income. Taxpayers choosing this path, however, have to use the LIFO method to prepare their financial statements and reports and have to follow certain procedures for additional bookkeeping. The IRS may terminate a taxpayer's use of the LIFO method when these requirements are not met.

During the past few years, the IRS has received numerous inquiries from taxpayers and many requests for guidance from field offices regarding the types of actions by taxpayers that are compatible with LIFO inventory valuation. The IRS responded this year by publishing Revenue Procedure 79-23, which sets forth examples of situations warranting the allowance or disallowance of the use of the LIFO method.

Updated procedure

During 1979, the IRS published Revenue Procedure 79-45, which revised and updated the procedures the IRS will follow in issuing rulings and determinations letters and in entering into closing agreements. This procedure also contained updated instructions for taxpayers to follow when requesting rulings and determinations. Revenue Procedure 79-46 revised and updated the procedures for furnishing technical advice to District Directors and Appeals offices and informed taxpayers of their rights when such advice is requested.

Internal Revenue Bulletin

The weekly Internal Revenue Bulletin announces official rulings and procedures of the IRS and published Treasury decisions, Executive orders, tax conventions, legislation, court decisions, and other items of general interest. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins. Weekly and semiannual issues are available to the public through the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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During 1979, the Bulletin included 388 revenue rulings, 62 revenue procedures, 26 public laws relating to Internal Revenue matters and 17 committee reports, 76 Treasury decisions containing new or amended regulations, 36 delegations orders, 2 Treasury Department orders, 19 notices of suspension and disbarment from practice before the IRS, 270 announcements of general interest, and 4 court decisions.

Making rulings public

The Tax Reform Act of 1976 provided that IRS rulings and technical advice memorandums generally be opened to public inspection after the deletion of the taxpayer's identity, trade secrets, and confidential commercial and financial information.

Rulings and technical advice requested after October 31, 1976, are usually made available within 90 days after they are issued to taxpayers. Some 25,000 of the approximately 83,000 issued in answer to requests made before November 1, 1976, were made available to the public in 1978. During 1979, the remaining 58,000 determinations written in the past were made available to the public, marking the end of the past rulings release program.

Internal audit

The Internal Audit Division appraises IRS operations to measure compliance with management policies, to determine whether procedures are in accordance with law and regulations, and to ascertain whether programs are carried out effectively, efficiently, and with integrity.

Audit emphasis is placed on IRS activities considered to be high-risk or having significant impact on taxpayer service and revenue collection. High priority is given to reviewing controls for safeguarding of tax information and assuring fair and equitable treatment of taxpayers.

Coordinated audits provide uniform coverage in a representative number of offices to evaluate a program on a national or regional basis. These audits give managers a better perspective on how their functions are operating, permit nationwide corrective action if necessary, and result in more effective use of audit resources.

Management actions on internal audit reports resulted in better service to taxpayers, strengthened controls, and improved operations with savings and additional revenue estimated at $302 million.

Abstracts of internal audit findings are distributed monthly to IRS officials to identify operational areas that may need increased attention. Periodic reports are made to top management on the implementation and effectiveness of actions taken on GAO reviews of IRS activities.

Indications of fraud, embezzlement, or other wrongdoing by IRS employees are investigated thoroughly. During the year, possible breaches of integrity by 134 employees and 110 other individuals were investigated. Of the investigations begun into these possible breaches, 23 investigations were completed in 1979. As a result, 25 employees and 11 others were cleared of allegations of improprieties, while actions were taken or are pending against 5 employees.

Internal security

The Internal Security Division protects the integrity of the IRS by investigating high-risk areas and alerting managers and employees to integrity hazards.

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The Division investigates complaints of criminal misconduct affecting IRS employees or operations and persons who attempt to bribe, threaten, or assault IRS personnel. It also investigates the unauthorized disclosure of tax information by employees or practitioners and other charges against tax practitioners.

The Division also investigates IRS job applicants and conducts special investigations and inquiries for the Commissioner and the Secretary of the Treasury.

During 1979, Internal Security inspectors arrested or were responsible for the indictment of 61 taxpayers or tax practitioners and 29 employees or former employees. During the year, 97 persons were convicted or pleaded guilty. Of these, 38 convictions were for bribery, 16 were for assault, and the remainder involved such criminal charges as conspiracy to defraud the Government, obstruction of justice, subscribing to false returns, disclosure of confidential tax information, and embezzlement.

In one case two former New York supervisory appraisers were convicted in a bribery scheme involving a multimillion-dollar estate tax fraud. The employees received approximately $65,000 over a 6-year period to lower estate property appraisals to reduce taxes owed. Other employees in this case were convicted as well as taxpayer representatives, accountants, attorneys, and executors of the estates.

Bribery awareness

The Division increased the number of bribery awareness presentations to IRS employees, expanding them to include video tapes that realistically portray bribery situations IRS employees may encounter. The effectiveness of these presentations may be gauged by the facts: Employees reported 246 possible bribery attempts resulting in 53 arrests or indictments.

Assaults and threats

Assaults and threats against IRS employees declined by 2.2 percent from 465 in 1978 to 455 in 1979.

Internal Security protects IRS employees threatened or assaulted while performing their duties and seeks vigorous prosecution of these cases. In instances where prosecution is declined—usually in verbal threat cases without physical assault—an inspector, with the approval of the U.S. attorney, contacts the alleged assailant to inform him or her of applicable Federal statutes concerning assaults or threats on Government employees. The person also is advised that repetitive acts could result in prosecution.

Checking the work force

The Internal Security Division completed 12,696 investigations of employees during the year and police record checks were conducted on all persons considered for temporary appointments.

These investigations and record searches resulted in the rejection of 98 job applicants, and disciplinary actions including dismissals, suspensions, reprimands, warnings, or demotions against 632 employees. Also, at the request of the Inspector General and of the Office of the Secretary of the Treasury, the Division conducted special investigations of employees of other Treasury bureaus.

While some investigations of IRS employees resulted in criminal prosecution or disciplinary action, in many cases employees were exonerated of accusations of misconduct.

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Taking precautions

In each region 125 integrity development projects initiated by Internal Audit and Internal Security probed high-risk IRS operations. As an alternative to merely reacting to complaints, allegations, or referrals, this approach is designed to identify and examine areas in IRS operations particularly susceptible to corruption and fraud.

BUREAU OF THE MINT[1]

The Mint became an operating bureau of the Department of the Treasury in 1873, pursuant to the Coinage Act of 1873 (31 U.S.C. 251). All U.S. coins are manufactured at Mint installations. The Bureau of the Mint distributes coins to and among the Federal Reserve banks and branches, which in turn release them to commercial banks. In addition, the Mint maintains physical custody of Treasury stocks of gold and silver; handles various deposit transactions, including inter-Mint transfers of gold and silver bullion; and refines and processes gold and silver bullion.

During fiscal 1979, functions performed by the Mint on a reimbursable basis included the manufacture and sale of proof coin sets and uncirculated coin sets, medals of a national character, and, as scheduling permitted, the manufacture of foreign coins.

The headquarters of the Bureau of the Mint is located in Washington, D.C. The operations necessary for the conduct of Mint business are performed at seven field facilities. Mints are situated in Philadelphia, Pa., and Denver, Colo.; assay offices are in New York, N.Y., and San Francisco, Calif.;[2] and bullion depositories are located in Fort Knox, Ky., (for gold) and West Point, N.Y. (for silver).[3] The Old Mint, San Francisco, houses the Mint Data Center, the Mint Museum, and a numismatic order processing operation.

During the year, the Mint shipped approximately 14.4 billion coins to the Federal Reserve banks, exceeding the alltime record of 13.4 billion pieces set in fiscal 1978. Shipments of the Anthony dollar coins accounted for about 454 million of the total. About 69 million of the Eisenhower dollars were shipped before the Mint's inventory was depleted in May 1979.

The Philadelphia Mint produced 5,411,295,000 coins; the Denver Mint 5,551,462,867 pieces; the West Point Bullion Depository manufactured 1,679,322,000 coins; and the San Francisco Assay Office 985,964,000 pieces for general issue.

The Bureau of the Mint deposited $1,039,856,204 into the general fund of the Treasury during fiscal 1979. Seigniorage on U.S. coinage accounted for $991,909,497 of the total. The revenues deposited were approximately 195 percent greater than the budgeted goal for the fiscal year. This was attributed primarily to the profit accruing from production of the Anthony dollar coin.

[1] Additional information is contained in the separate Annual Report of the Director of the Mint.
[2] The San Francisco Assay Office also operates as a mint.
[3] Coinage operations are also performed at the West Point Bullion Depository.

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Domestic coinage

On October 10, 1978, President Carter approved legislation[4] (Public Law 95–447) which amended the Coinage Act of 1965 to provide for changes in the weight, size, and design of the $1 coin. The legislation also provided that the Secretary of the Treasury might continue to mint and issue the Eisenhower dollar coin until January 1, 1979.

After the initial development of the coin, the Mint's Office of Technology conducted trial strikes and experimental production lots. Prior to full-scale production, specifications for the new dollar coin were developed. The coin, with a diameter of 26.5 millimeters, weighing 8.1 grams, is a cupronickel-clad coin. The cladding is an alloy of 75 percent copper, 25 percent nickel, which constitutes 50 percent of the total thickness of the coin. The core is pure copper.

The initial production of the Susan B. Anthony dollar took place at the Philadelphia Mint on December 13, 1978, when the Director of the Mint started the coin presses, at ceremonies participated in by Under Secretary Anderson, other Treasury and Mint officials, Members of Congress, and officials of the Federal Reserve. Early in January the manufacture of the coin was begun at the Denver Mint. On February 2, 1979, Secretary Blumenthal[5] joined Director Hackel at the San Francisco Assay Office to observe the production of the dollar coin and to start one of the coin presses used to strike the 1979 proof Anthony dollar. Each of these Mint facilities stamped its own identifying Mint mark on each dollar coin. The manufacture of the dollar coins was begun early in order to accumulate an inventory of 500 million pieces prior to their release to commercial banks through the Federal Reserve System in July 1979.

The Anthony dollar coins were released to the public on July 2, 1979. The Mint's prerelease goal of 500 million coins had been achieved by that date. By September 30, 1979, approximately 682 million of the dollar coins had been struck and shipments to the Federal Reserve banks amounted to about 454 million coins.

The Mint manufactured, during the fiscal year, for general circulation, cupronickel-clad dollars, half dollars, quarters and dimes, cupronickel 5-cent coins, and 1-cent coins composed of 95 percent copper, 5 percent zinc.

Mint production of the Eisenhower dollar coins was terminated on December 31, 1978. Approximately 34 million of these large cupronickel-clad dollars were struck during the first quarter of the fiscal year.

Coinage strip for the manufacture of U.S. coinage was obtained from both in-house fabrication and outside sources. All 5-cent, 10-cent, and 25-cent strip for the Philadelphia Mint was fabricated in-house. Coinage strip used by the Denver Mint and the San Francisco Assay Office was purchased on the open market. Most of the annealed/cleaned 1-cent blanks for West Point were furnished by the Philadelphia Mint, with lesser quantities purchased from commercial suppliers.

The Mint maintained its close liaison with the Federal Reserve in determining coin requirements. Demand for coin, as measured by the net outflow from Federal Reserve banks to commercial banks, totaled 13.7 billion coins. This represented an increase of only about 4 percent over fiscal 1978. Joint Mint/Federal Reserve inventories decreased from 1978 to 5.7 billion coins as of September 30, 1979.

The direct shipment of coins under certain limited conditions from the Mint to commercial banks or facilities was expanded during the year. Coin

[4] See exhibit 17. See also 1978 Annual Report, p. 215.

[5] See exhibit 22.

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shipments to such facilities must be accepted by agents designated by the Federal Reserve bank. By the fiscal yearend, direct shipments were being made to 17 offsite facilities. A reduction of $190,000 in labor and transportation costs and a savings of approximately 13,000 gallons of fuel are expected to accrue to the Government as a result of the direct shipments.

U.S. coins manufactured, fiscal year 1979

Denomination	General circulation		Numismatic [1]		Total coinage	
	Number of pieces	Face value	Number of pieces	Face value	Number of pieces	Face value
1 dollar:						
Cupronickel..	[2] 681,995,696	$681,995,696.00	2,861,993	$2,861,993.00	684,857,689	$684,857,689.00
Silver-clad			203,365	203,365.00	203,365	203,365.00
50 cents:						
Cupronickel..	51,524,299	25,762,149.50	2,861,993	1,430,996.50	54,386,292	27,193,146.00
Silver-clad			203,365	101,682.50	203,365	101,682.50
25 cents:						
Cupronickel..	921,449,652	230,362,413.00	2,861,993	715,498.25	924,311,645	231,077,911.25
Silver-clad			203,365	50,841.25	203,365	50,841.25
10 cents	626,170,040	62,617,004.00	2,861,993	286,199.30	629,032,033	62,903,203.30
5 cents	761,213,280	38,060,664.00	2,861,993	143,099.65	764,075,273	38,203,763.65
1 cent	10,585,690,900	105,856,909.00	2,861,993	28,619.93	10,588,552,893	105,885,528.93
Total	13,628,043,867	1,144,654,835.50	17,782,053	5,822,295.38	13,645,825,920	1,150,477,713.88

[1] All numismatic coins were made at the U.S. Assay Office, San Francisco, and consisted of 1,077,232 1978 proof sets, 1,784,761 1979 proof sets, and 203,365 silver-clad Bicentennial sets (71,607 proof, 131,758 uncirculated). Production of Bicentennial coins ceased on Dec. 31, 1976; however, sets continued to be packaged and sold after that date. Bicentennial sets reported in this table were packaged and sold during fiscal 1979.

[2] Consists of 33,500,890 Eisenhower dollars produced in 1978 and 648,494,806 Susan B. Anthony dollars manufactured through Sept. 30, 1979.

NOTE.—Dollars, half dollars, quarters, and dimes for general circulation and regular proof sets are three-layer composite coins—outer cladding 75 percent copper, 25 percent nickel, bonded to a core of pure copper. Dollars, half dollars, and quarters comprising the Bicentennial proof and uncirculated sets are three-layer composite coins with a outer cladding 800 parts silver, 200 parts copper, bonded to a core approximately 209 parts silver, 791 parts copper.

Bureau of the Mint operations, fiscal years 1978 and 1979

Selected items	Fiscal 1978	Fiscal 1979
Newly minted coins issued: [1]		
1 dollar	50,000,000	522,600,000
50 cents	78,400,000	101,700,000
25 cents	997,900,000	1,029,600,000
10 cents	1,184,600,000	1,227,400,000
5 cents	971,300,000	938,100,000
1 cent	10,185,800,000	10,543,700,000
Total	13,448,000,000	14,363,100,000
Inventories of coins in mints, end of period	3,227,600,000	2,492,500,000
Electrolytic refinery production:		
Gold—fine ounces	2,040,848.525	2,778,706.738
Silver—fine ounces	3,257,560.10	2,960,058.42
Balances in Mint, end of period:		
Gold bullion—fine ounces	266,393,521	254,538,826
Silver bullion—fine ounces	39,208,331	39,064,383

[1] For general circulation only.

Reimbursable programs

Foreign coinage.—The Bureau of the Mint is authorized to produce coinage for foreign governments on a reimbursable basis provided that the manufacture of such coins does not interfere with U.S. coinage requirements. During

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the year, Mint installations produced 37,589,090 coins for the Dominican Republic, Haiti, and Panama.

Medals.—During fiscal 1979, design and engraving work were in process for four congressionally authorized medals in recognition of distinguished service, careers, or feats of outstanding citizens. The legislation and the subjects of the medallic recognition were: Public Law 95-438, enacted October 10, 1978, honoring Lt. Gen. Ira C. Eaker, USAF (retired);[6] Public Law 95-560, enacted November 1, 1978, in recognition of the late Robert F. Kennedy;[7] Public Law 96-20, June 13, 1979, in recognition of the transatlantic balloonists Ben Abruzzo, Maxie Anderson, and Larry Newman;[8] and Public Law 96-21, also enacted June 13, 1979, in recognition of the dedicated and distinguished service of Hubert H. Humphrey[9].

On May 26, 1979, the President signed Public Law 96-15 authorizing the striking of a gold medal in recognition of John Wayne's service to the nation as well as his distinguished acting career[10]. The gold medal was struck during the fiscal year for presentation to his family by the President. Following presentation of the gold medal to Mr. Wayne's family, the public will be able to purchase bronze replicas of it in 3-inch and 1 5/16-inch sizes. Based on the fact that the Mint had received more than 35,000 orders for the 3-inch and over 34,000 orders for the smaller medal before they were available, the John Wayne medal is potentially the most popular medal ever offered for sale by the Mint.

The Stella B. Hackel, Director of the Mint medal was completed during the fiscal year and added to the Mint's national medals listing.

Gold medallions.—On November 10, 1978, title IV, Public Law 95-630, the American Arts Gold Medallion Act,[11] was approved by the President. This legislation, effective October 1, 1979, provides that the Secretary of the Treasury, during each of the first 5 calendar years beginning after the date of enactment, shall strike and sell to the public 1 troy ounce and one-half troy ounce, 900 fine, gold medallions. During the first year, at least 500,000 fine troy ounces of gold are to be struck in each size medallion. The legislation provides that the medallions honor 10 specified American artists. The designs of the first two medals in the series, to honor Marian Anderson and Grant Wood, respectively, were completed and approved during fiscal 1979. The half-ounce gold medallions will be struck with the likeness of Marian Anderson on the obverse; Grant Wood's picture will appear on the obverse of the first 1-ounce gold medallion of the series.

Specifications, cost studies, and a solicitation for purchase of gold blanks for the American arts gold medallions were developed during the fiscal year. The funds to provide for the production and marketing costs were included in the Mint's fiscal 1980 budget amendment.

Special coin program.—The Mint began offering the 1979 proof coin sets for sale to the public on April 2, 1979, at $9 per set. The sets, struck at the San Francisco Assay Office, contain one coin of each current denomination, including the new Susan B. Anthony dollar. The ordering period was closed on May 11, 1979, after orders had been received for more than 3.7 million sets. The unusually high demand for these sets was attributed to the introduction of the new coin. Initial shipment of the sets was delayed until

[6] See exhibit 18.
[7] See exhibit 20.
[8] See exhibit 29.
[9] See exhibit 30.
[10] See exhibit 28.
[11] See exhibit 21.

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July 2, when the circulating Anthony dollars were released to the public. All sets are scheduled to be shipped by the end of December.

During the year, 2.2 million uncirculated 12-coin sets (consisting of 1 coin of each denomination struck at both the Philadelphia and Denver Mints) were shipped to customers who had ordered them between September 5 and October 31, 1978.

The Mint continued to offer the 40-percent silver-clad Bicentennial proof and uncirculated coin sets for sale through the middle of September 1979. The uncirculated sets were priced at $9, but under the bulk rate program established in August 1975 the uncirculated sets in multiples of 50 sets were sold at $7 per set. The bulk rate program was terminated on September 17, 1979, when the open market price of silver reached a level at which the value of the silver in each coin set exceeded the $7 price. On September 19, 1979, the sale of all uncirculated Bicentennial sets was stopped for the same reason. The proof Bicentennial sets were still being sold at $12 per set at the fiscal yearend.

Gold refining and audit of gold holdings

The U.S. Assay Office at New York is the only Federal facility that refines gold and silver bullion. During the fiscal year, an intensive "make or buy" study of the comparative costs of refining the Treasury's remaining gold deposits was conducted in accordance with the new OMB policy document, Circular A-76. The study revealed that Assay Office costs were considerably lower than the best bid from the private sector. This resulted in a decision to continue refining gold at the New York Assay Office.[12] During the fiscal year, substantial progress was made in reducing costs, and the output of refined gold was increased by more than 25 percent. The Department estimated that the increase in productivity would result in savings of approximately $300,000 this fiscal year, with savings of $400,000 anticipated in fiscal 1980. It was estimated that the remaining unrefined gold would be refined within approximately 5 years, after which the refinery would be closed.

The Continuing Committee for the Audit of U.S.-owned gold located at various depositories at appropriate intervals was established by the Fiscal Assistant Secretary during fiscal 1976. The Committee consists of one representative each from the Bureau of the Mint, the Bureau of Government Financial Operations, and the Federal Reserve Bank of New York, with representatives of the General Accounting Office invited to participate in the audits as observers. During fiscal 1979, gold audits were performed in three of the four Mint depositories where gold is stored (Fort Knox, Ky.; U.S. Assay Office, New York; and the Denver Mint). By September 30, 1979, more than 60 percent of the U.S.-owned gold had been audited and verified. The continuing audit is planned to provide for a complete audit of U.S.-owned gold over a 10-year cycle ending in 1984.

Miscellaneous

The transfer of Treasury payroll/personnel information system (TPPIS) operations begun in fiscal 1978 continued on a periodic basis during fiscal 1979. All programs, libraries, files, and procedures had been transferred to the Office of the Secretary by the fiscal yearend.

[12] See exhibit 32.

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Computer terminals were installed at all Bureau of the Mint field locations except Fort Knox. These terminals were procured to: allow payroll and personnel processing compatability with TPPIS; satisfy existing and future remote job entry requirements; and, eventually, replace electrical accounting machines.

The Mint-wide improvement/expansion study initiated during fiscal 1978 to find ways to expand coin production capacity and improve the work environment in the coin manufacturing plants was completed. A plan was submitted to Under Secretary Anderson to expand coin production, improve workflow, materials handling, and work environment, and relieve congestion in work areas within the mints. The current plan eliminates the construction of a new Denver Mint which had been included in the original plan. The plan was approved by the Under Secretary; OMB approval was pending at the fiscal yearend.

The Mint security program provides appropriate and continuous protection for all employees and assets under the jurisdiction of the Bureau of the Mint. This is accomplished by the Mint Security Force, supported by extensive and sophisticated alarm systems, closed-circuit television coverage, special vaults or other controlled locking devices, and the Bureau's personnel security clearance program.

During fiscal 1979, a total of 24 Mint security officers completed the 5-week police training course at Treasury's Federal Law Enforcement Training Center.

Extensive security surveys were conducted throughout the Mint during the year. The U.S. Secret Service performed technically oriented surveys at each Mint coining facility. A Mint security task force reviewed the policies and managerial procedures used to administer the security program.

The Mint's first industrial hygiene program was implemented during the year at all field offices. This program will facilitate Mint compliance with OSHA/NIOSH standards by establishing the capability to acquire and analyze ambient air in work spaces and to identify areas in which noise levels are exceedingly high.

Annual occupational safety and health surveys were accomplished at each Mint facility. These surveys indicated significant decreases in disabling injuries from the previous year.

The Mint Office of Technology, in collaboration with the U.S. Secret Service and the U.S. attorney, Providence, R.I., assisted in several convictions of manufacturers and distributors of slugs the size of 25-cent coins.

Internal audits were made during the year of numismatic sales functions, melting and refining activities at the New York Assay Office, procurement practices at the Philadelphia Mint, and controls over travel expenditures and cash assets at the Denver Mint. Concurrent lateral audits of appropriation accounting and payroll activities at all field offices were conducted. Audit work contributed to the strengthening of internal controls and accounting and reporting systems; more effective management of numismatic sales facilities; improved accountability and reporting of precious metals; and improved safety awareness.

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OFFICE OF REVENUE SHARING[1]

The Office of Revenue Sharing (ORS) is located in the Office of the Assistant Secretary (Domestic Finance) for administrative purposes. The revenue sharing staff consists of approximately 160 professional and clerical positions with offices located at 2401 E Street, NW. in Washington, D.C.

During fiscal 1979, $6.8 billion in revenue sharing funds were distributed to more than 38,000 States, counties, cities, towns, townships, Indian tribes, and Alaskan native villages. This brought to $42.15 billion the amount of money returned to State and local governments since the beginning of the general revenue sharing program in 1972.

The State and Local Fiscal Assistance Act of 1972 (31 U.S.C. 1221-1263) authorized the distribution of $30.2 billion during the 5-year period that ended December 31, 1976. The money was allocated according to formulas contained in the law which use data on population, per capita income, and general tax effort for each recipient government.

The 10th entitlement period in the general revenue sharing program is the 3rd entitlement period authorized by the State and Local Fiscal Assistance Amendments of 1976 (31 U.S.C. 1221 note). These amendments extended general revenue sharing from January 1, 1977, through September 30, 1980, at higher annual levels of funding than had been previously authorized. The amended act authorizes $6.8 billion for distribution for the 10th period, bringing the total authorized for distribution since 1972 to $49 billion.

Systems Division

The Systems Division developed information systems for all of the compliance areas: (1) Civil rights, (2) audit, and (3) public participation. These new systems make instant checking of the status of individual cases or reviews possible, providing basic details of each situation if required. An officewide correspondence tracking system has also been designed and implemented. These new systems have been instrumental in the Office's maintaining productivity levels with a decreased level of staffing. Additional administrative changes are also under consideration.

Data improvement

The Office of Revenue Sharing has continuously sought to obtain the most current and accurate data available for use in the formula allocation process, thereby assuring that all funds are distributed equitably. These data are obtained from several sources, including the Bureau of the Census, the Bureau of Economic Analysis, the Bureau of Indian Affairs, and the Internal Revenue Service.

All four data factors relating to local governments were revised for the allocation of funds for entitlement period 11, which extends from October 1, 1979, through September 30, 1980. Population estimates for all governments were updated to July 1, 1977, and the adjusted taxes and intergovernmental transfer data elements were each updated to fiscal 1978. The 1975 per capita income estimates used previously in the initial 10th period allocations were completely revised based upon new State and county income data provided by the Bureau of Economic Analysis. These data were used in the computation of adjusted (final) 10th period allocations and the initial allocations for period 11.

[1] Additional information is contained in the separate Annual Report of the Office of Revenue Sharing.

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The Office has, since the beginning of the program, recognized the need for special efforts to ensure the validity of its data. The cornerstone of these efforts is the annual data improvement program, which consists of notifying each government of the individual data elements to be used in computing its allocation, as well as an estimated allocation amount based upon these data. Each government is then asked to examine its data factors based on established data definitions, and to propose corrections for any data element believed to be in error.

During the data improvement program for the 11th period, 1,900 governments responded with challenges to 1 or more of their data elements. Of these, approximately 500 resulted in changes to the data. Altogether, as a result of this program and the Census Bureau's ongoing data review, over 3,000 revisions have been made to the data used in the computation of the period 11 allocations.

The State and Local Fiscal Assistance Act of 1972, as amended, and regulations promulgated under title II of the Public Works Employment Act of 1976, as amended (antirecession fiscal assistance), require each State and local government which receives funds to supply information on its annual fiscal transactions, including data on the expenditure of funds received through either of these programs. A report has been published on the data submitted by the State and local governments entitled "Expenditures of General Revenue Sharing and Antirecession Fiscal Assistance Funds 1976–1977." It presents the data aggregated by type of government according to demographic, geographic, and socioeconomic variables. In addition, individual government data are presented for all States, for the 63 largest counties, and for the 46 largest municipalities.

Technical assistance

The Office of Revenue Sharing provides information and technical assistance to State and local governments receiving general revenue sharing funds.

Technical assistance was provided to recipients through more than 2,000 letters in response to written requests for specific information and guidance. In addition, thousands of telephone contacts were made with recipient governments, various organizations, and others interested in the revenue sharing program. Eight technical papers have been prepared on various areas of the program. More than 50,000 individual mailings of these and other informational materials were made during the year.

The Office has established a network of liaison offices within each of the 50 States. Over 100 technical assistance workshops were conducted during the year in cooperation with these liaisons and other cosponsors for the benefit of recipient governments.

Quarterly, each of the more than 38,000 recipient governments was sent an informational letter to help them with participation and compliance requirements of the program.

Public participation

A new handbook was published and distributed during the year informing recipient governments and public interest groups of the new revenue sharing public participation requirements of the 1976 amendments. These provisions require two public hearings by State and local governments receiving revenue sharing funds prior to the use of such funds, with attendant public notice and opportunity for examination of budget documents and use reports.

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A series of publications was developed designed to assist recipient governments in understanding the new requirements. Public participation compliance investigations were conducted in more than 117 recipient jurisdictions. Direction was provided to those governments which had failed to comply with public participation requirements, to enable them to take voluntary corrective action.

A new procedures manual for the processing of cases was completed this year. Its purpose is to provide uniform standards for the handling of public participation compliance investigations.

Civil and human rights

Section 122 of the Revenue Sharing Act provides that: "No person in the United States shall, on the ground of race, color, national origin, or sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity of a State government or unit of local government, which government or unit receives funds * * *. Any prohibition against discrimination on the basis of age under the Age Discrimination Act of 1975 or with respect to an otherwise qualified handicapped individual as provided * * * shall also apply to any such program or activity. Any prohibition against discrimination on the basis of religion, or any exemption from such prohibition, as provided * * * shall also apply to any such program or activity."

Although the Civil Rights staff is small, it has investigated a significant number of complaints, many of which have been closed through negotiation and voluntary compliance. In those instances where recipient jurisdictions have been reluctant to take the necessary steps to comply with civil rights requirements, the Office has initiated action compelling them to do so.

Shown below is a table that demonstrates the growth of the activities of the Division.

Discrimination complaints

Year	Received	Determinations/ findings	Closed	Carried over
1972	2	0	0	2
1973	27	1	2	27
1974	75	14	26	76
1975	213	8	29	260
1976	229	7	71	418
1977	276	125	142	552
1978	306	156	184	674
1979	330	179	228	776

Note.—The most significant unit of work measurement is the determinations/findings issued, rather than number of complaints closed. The major portion of the work process is completed upon the issuance of a determination/finding. Usually, the closure of the case is dependent upon a review and analysis of requested information from a recipient government after the issuance of a noncompliance determination, or finding.

The Office continues to work in a cooperative effort with several Federal agencies to help resolve discrimination complaints and to assist in conducting field investigations. The Office is attempting to renegotiate cooperative agreements with the Federal agencies with which it has shared agreements.

A new handbook was prepared to assist both recipient governments and the general public in understanding the civil rights requirements of the program.

The basic technical memorandum relating to civil rights case processing was updated and improved during the year. Work on a more extensive manual was begun near the end of the year.

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Auditing

The 1976 amendments to the Revenue Sharing Act require each recipient government receiving $25,000 or more annually in revenue sharing entitlements to have an independent audit of its financial statements in accordance with generally accepted auditing standards, not less often than once every 3 years to determine compliance with the act. This requires a financial audit of all funds and a compliance audit of revenue sharing and antirecession fiscal assistance funds. The audit requirements are applicable to more than 11,000 of the nearly 38,000 revenue sharing recipients.

During fiscal 1979, the Office completed a second review of the professional practice of State auditors. These reviews were in more depth than the initial reviews and disclosed additional State audit agencies whose audit reports were unacceptable. There are 63 State audit agencies involved in auditing of State and local governments. In some States one State agency audits the State's accounts and another one audits local governments. A total of 20 State audit agencies were found to be unacceptable. Of these, 5 have attained an acceptable status, with the remaining 15 implementing programs to attain acceptability within the time limit required by the audit provisions of the act.

The professional practices of 84 independent public accountants were reviewed this year. As of September 30, 1979, 64 reviews had been completed, 21 of which were unacceptable. Replies have been received from 12 of those whose practice was found to be substandard indicating that they would make the necessary changes to bring their practice to an acceptable status. Two CPA's and one public accountant who were recalcitrant were reported to the Ethics Committee of the American Institute of CPA's and the State Board of Accountancy, respectively. In all three cases the recipients were informed that the audits were unacceptable.

Copies of audit reports must be submitted to the Office if they disclose violations of the Revenue Sharing or Antirecession Fiscal Assistance Acts and regulations. Copies of audit reports issued by independent public accountants for which a State auditor has no legal responsibility must also be furnished. State auditors provide the Office with a quarterly report listing audit reports which they issue or receive for review from independent public accountants that do not contain findings of violations. These reports are kept on file by the State auditors for review by the Audit Division as a part of the periodic reviews made of State auditors' performance.

An automated audit tracking system was developed and installed during the year to provide information as to the number of recipients' audit reports that have been received, whether they are acceptable, whether the audits were performed by State auditors, local government auditors, CPA's, or public accountants, and whether the financial statements are in conformity with generally accepted accounting principles or some other accounting basis.

During the fiscal year, 1,332 acceptable audit reports were received from local governments. An additional 1,255 acceptable reports were received and reviewed for ORS by State auditors. There were 416 unacceptable reports submitted to either ORS or State auditors. At the end of the year 575 partial reports had been accepted, but still required additional information to meet the requirements of the program.

In fiscal 1979, 183 cases were opened of which 173 resulted from findings of audit reports. Cases closed totaled 259. Thus, open cases were reduced from 178 to 102, or a decrease of 76 during the year. As of September 30, 1979, there were only 29 cases that had been open for a year or more.

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The Audit Division also responded to 4,158 requests from independent public accountants for confirmation of entitlement fund payments.

Research and analysis

The Revenue Sharing Act, as amended by the State and Local Fiscal Assistance Amendments of 1976, is scheduled to expire at the end of September 1980. In preparation for the program's legislative reauthorization process, ORS conducted research projects analyzing the program's impact. Analyses emphasized the fiscal, economic, and distributional impacts of general revenue sharing on State and local recipient governments, and on the national economy. They were conducted both by ORS staff and by external contractors. Studies also examined the effect of the audit, public participation, and nondiscrimination compliance requirements of the revenue sharing law.

Analyses were performed on alternative allocation formulas which might adapt the program to changing national needs and the fiscal needs of State and local governments.

A series of research studies were published to assist those interested in the impact of the general revenue sharing program and its future.

Legal issues

During the fiscal year, ORS participated in five administrative hearings involving determinations of discrimination on the basis of race or sex. One of these, involving the city of Jacksonville, Fla., was concluded on the merits with a decision by the administrative law judge in favor of the ORS. The city filed a petition for review with the U.S. Court of Appeals for the Fifth Circuit.

Another administrative hearing resulted in preliminary findings adverse to the ORS, and is proceeding to a full hearing on the merits. Three more administrative proceedings resulted from district court discrimination holdings against the cities of New York, Buffalo, and Baltimore. These were concluded with compliance agreements entered into pursuant to the amended Revenue Sharing Act. A sixth proceeding was dismissed upon demonstration by the revenue sharing recipient government that it had complied with the nondiscrimination requirements of the act.

The ORS Legal Division participated in a number of court cases involving discrimination, data protests, and formula methodology in determining the entitlements. Some of these are continuations of legal proceedings described in the 1978 Annual Report of the Secretary.

In *Board of Supervisors of Henrico County, Virginia* v. *W. Michael Blumenthal, et al.* (U.S.D.C., W.D. Va.) the district court entered a decision adverse to ORS and directed a recomputation of the county's entitlement for certain past periods using a methodology vigorously opposed by ORS. That decision is being appealed to the U.S. Court of Appeals for the Fourth Circuit.

In another case previously reported, *Committee for Full Employment* v. *Simon,* the U.S. Court of Appeals for the District of Columbia reversed the ruling of the district court, and ruled that the plaintiffs did have standing to sue; the appeals court remanded the complaint to the district court for disposition of any remaining claims.

In *Goolsby* v. *Blumenthal,* the U.S. Court of Appeals for the Fifth Circuit reversed a decision of a three-judge panel, and reinstated the judgment of the district court that the Uniform Relocation Assistance and Real Property Acquisition Act of 1970 did not apply to the allocation and distribution of

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revenue sharing funds. The case was considered critical to administration of the general revenue sharing program.

In *Profit* v. *City of Niagara Falls, et al.* (U.S.D.C., W.D. N.Y.) ORS won a significant victory when the district court decided, in effect, that the Director of the Office of Revenue Sharing was acting within her discretion in reversing a prior determination of discrimination on the basis of new evidence. The plaintiff filed an appeal with the U.S. Court of Appeals for the Second Circuit where the case is pending for argument.

The Legal Division participated in negotiating compliance agreements and settlement of several civil rights cases with New York, N.Y.; Buffalo, N.Y.; San Francisco, Calif.; and Mobile, Ala.

In the legislative area, the Legal Division participated in drafting a bill to extend the antirecession fiscal assistance (ARFA) program, and to establish a program of targeted fiscal assistance.

A proposed revision of ORS regulations is planned for early 1980. New sections concerning ORS handicap and age discrimination regulations have been drafted (31 CFR SS 51.55 and 51.56, respectively). The handicap regulations have been approved by the lead agency in this area (HEW, Executive Order 11914) and have reached the stage of final review by the Assistant Secretary for Domestic Finance. ORS expects to publish the proposed revenue sharing age discrimination regulations in the near future. Additionally, ORS published on April 2, 1979, interim regulations clarifying the definition of "program or activity" (31 CFR S 51.51(j)) and the definition of "funding" (31 CFR S 51.51(e)).

During the fiscal year, ORS negotiated cooperative agreements concerning nondiscrimination with the Office of Personnel Management and LEAA.

Additional agreements with the Departments of Justice, Labor, HEW, and HUD were under discussion at the end of the fiscal year. Finally, the ORS issued approximately 350 letter rulings to recipient governments seeking guidance for the use of ARFA and revenue sharing funds.

OFFICE OF TARIFF AFFAIRS

The Office of Tariff Affairs, which provides policy direction and review of recommendations by the Customs Service on administration of the Antidumping Act and the countervailing duty law, continued to meet a heavy caseload during the fiscal year, with antidumping cases having increased 57 percent over the 1977 level and decreased 38 percent below the 1978 level; countervailing duty investigations are equal to the 1977 level and 48 percent below the 1978 level.

The Office continued oversight of the trigger price mechanism for monitoring of steel imports for the purpose of determining when self-initiation of antidumping investigations of imported steel products might be appropriate.

During fiscal 1979, the Treasury initiated 30 antidumping investigations and reached final determinations of sales at less than fair value in 21 cases. There were 13 dumping findings during that time. Over the same period, the Treasury initiated 15 investigations under the countervailing duty law, made 15 affirmative determinations and 12 negative decisions. Two waivers of

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countervailing duties were issued during that time. During the year, the Office also provided assistance to Treasury participants in the multilateral trade negotiations insofar as they related to negotiation of countervailing duty and antidumping codes and in preparing implementing legislation.

UNITED STATES CUSTOMS SERVICE

The U.S. Customs Service assesses, collects, and protects the levying of import duties and taxes; collects import and export statistics; enforces customs and related laws against contraband smuggling; controls carriers, persons, and articles entering or departing the United States by enforcing the Tariff Act of 1930 and other statutes and regulations governing international traffic and trade; and enforces the reporting requirements of the Bank Secrecy Act by investigating financially motivated crime involving currency reporting violations.

To accomplish these missions designed to protect American trade and commerce and the safety of American citizens, Customs—

1. Acts as the principal border enforcement agency by enforcing more than 400 laws and regulations on behalf of more than 40 Government agencies to protect international traffic and trade.
2. Detects and prevents smuggling and other attempts to effect illicit entry into the United States of prohibited articles, narcotics, drugs, and other contraband.
3. Detects and investigates illegal activities to apprehend violators and effectively reduce, deter, and prevent violations of laws and regulations enforced by Customs.
4. Examines and clears carriers, persons, and merchandise to collect customs duties, taxes, fees, fines, and penalties in compliance with customs laws applying to international commerce.

During fiscal 1979, Customs collected a record $8.46 billion in duty and taxes and processed $200.6 billion worth of imports requiring over 4 million formal entries (those over $250 in value). Some 46.5 million foreign mail parcels processed in fiscal 1979 required nearly 2 million informal mail entries.

Customs cleared more than 269 million persons entering the United States, more than 81.5 million vehicles, 161,462 vessels, and 445,540 aircraft. This involved processing 16.9 million customs declarations.

Customs seized illicit drugs, prohibited articles, and undeclared merchandise valued at more than $3 billion. The more than 21,300 drug seizures included: 1,438 pounds of cocaine, 15.9 million units of polydrugs, 1,791 tons of marijuana, and 122.5 pounds of heroin.

Modernization

Customs Procedural Reform Act

Enacted at the close of calendar 1978, the Customs Procedural Reform and Simplication Act (Public Law 95-410) was a product of cooperative efforts among the Customs Service, the Congress, and the importing community. The act eliminated many antiquated procedures and permitted Customs to

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institute major administrative and operational reforms of benefit to travelers and traders. Customs initiated an intensive internal review of regulatory changes to filter out those that were unnecessary or inappropriate.

While regulations implementing these reforms could not be instituted by the date of the act's enactment, Customs implemented all required changes during fiscal 1979, issuing directives, guidelines, and policies. In fiscal 1979, final regulations and four rulemakings were published in the Federal Register amending Customs Regulations to conform to, or reflect the Customs Procedural Reform Act of 1978:

T.D. 78-394, published October 1978, set forth conforming amendments to the Customs Regulations required by the act.

T.D. 79-160, published June 1979, set forth amendments relating to fines, penalties, forfeitures, and liquidated damages incurred for violations of laws administered by Customs.

T.D. 79-159, also published June 1979, set forth amendments relating to reporting requirements for customhouse brokers, recordkeeping, trademarks, and the disposition of forfeited alcoholic beverages.

T.D. 79-221, published August 1979, set forth amendments relating to the entry of merchandise, liquidation of entries, warehousing periods, and the marking of bulk containers of alcoholic beverages.

Public Law 95-410 also made substantial amendments to 19 U.S.C. 1592, the principal civil fraud statute administered by Customs. The maximum amounts of penalties for violations of the statute were altered and many procedural provisions were added or changed.

Customs' experience, and that of the trade community, has been favorable in the implementation and intent of the act.

Headquarters reorganization

On August 1, 1979, Customs began implementing a major reorganization of its headquarters office. The main objectives are to structure a tightly knit policymaking organization at the headquarters level, to achieve a more streamlined headquarters structure, and to stabilize the size of the headquarters at reduced levels. In addition, Customs designed the new framework to achieve a more balanced emphasis on both the commercial and enforcement components of the Service. As the first step in reorganization, Customs established four major offices: The Office of the Comptroller, the Office of Border Operations, the Office of Commercial Operations, and the Office of Management Integrity.

Miscellaneous

As a result of Executive Order 12044, Customs published semiannual agenda of significant regulations under development or review in the Federal Register in February and August. During fiscal 1979, to improve service, Customs significantly increased the number of Customs rulings, representing its official position on significant matters of widespread interest. These rulings were published in the Customs Bulletin for the information and guidance of the public and in the Customs issuance system (CIS) for direct distribution to Customs field personnel. In the first 10½ months of fiscal 1979, Customs published 427 decisions in the Customs Bulletin and 671 through the CIS.

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Trade

Trade Agreements Act of 1979

The act was signed by the President on July 26 and was the result of very close cooperation among international trade interests to revise outmoded rules affecting international commerce. Customs participated in meetings and discussions with the International Trade Commission, the Office of the Special Trade Representative, other Federal agencies, and international organizations including the Customs Cooperation Council to help formulate the new Trade Agreements Act. The act enables Customs to modernize handling of such areas as valuation, antidumping and countervailing duty procedures, tariff rates, government procurement, and dispute settlement.

Improved drawback procedures

To eliminate unnecessary paperwork, Customs changed the drawback regulations dealing with the establishment and amendment of drawback rates. Under the new regulations, a person no longer submits a separate drawback application and drawback proposal. Instead, Customs considers the drawback proposal to include the application.

Customs further streamlined drawback procedure by establishing a 15-year effective period for drawback contracts. This eliminated the requirement for the Customs Service to retain indefinitely out-of-date drawback contracts and encouraged drawback claimants to review their drawback contracts periodically.

Antidumping and countervailing duty

The Trade Agreements Act of 1979 substantially modifies the antidumping and countervailing duty statutes. The act imposes a material injury test, provides for provisional relief, and reduces the time for a countervailing duty investigation. Also, the act establishes new procedures intended to expedite antidumping investigations and to ensure timely assessment of antidumping duties when due.

During fiscal 1979, 41 antidumping investigations were started, 14 findings of dumping were issued, and 21 cases were terminated on the basis of agreements with the petitioners.

Trigger price mechanism (TPM).—Customs uses the TPM to monitor imports of steel mill products and to enable Treasury to self-initiate an antidumping investigation when warranted. Moreover, Customs took significant actions to increase the effectiveness of the TPM, including development and use of intensive audits and preclearances as well as amendments to Customs Service regulations.

Customs initiated four antidumping investigations on the basis of TPM information. They involved imports of carbon steel plate from Poland, Taiwan, and Spain, as well as wire nails from Korea. The Spanish plate was found to be "dumped," causing injury to a regional market in the United States. Although Customs found the plate from Poland selling at less than fair value, the International Trade Commission ruled that Polish plate imports were not causing injury to a U.S. industry.

In fiscal 1979, the volume of steel imports decreased, the profits of U.S. steel companies increased as did their operating capacity, and employment in the domestic steel industry rose. Thus, the TPM appears to have helped the U.S. steel industry.

In December 1978, Treasury initiated a program of comprehensive audits of steel-importing companies to supplement informal inquiries into steel

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import transactions and assure effective monitoring under the TPM. Primarily subject to audit are companies in which the exporter and importer are related by corporate ownership. Among the items Customs examined were the resale price to the first unrelated purchaser of the steel in the United States, claims of "secondary" quality material, credit terms, and importer's costs.

In fiscal 1979, Customs audited four major steel importers to verify the entry information they provided. Teams of Customs accountants and auditors have conducted 3-week, onsite examinations of company books to verify and trace every imported steel transaction for a designated period of time. These audits have not revealed any significant evasions of the TPM.

Some companies claim that, while they are selling below trigger prices, their sales are above "fair value" within the meaning of the Antidumping Act. (Basically, fair value equates to the price of the same or similar goods sold in the market of the exporting country for home consumption.) Therefore, Customs established a preclearance procedure to verify these claims, and thus prevent the initiation of unwarranted antidumping investigations under the TPM. Customs has granted preclearances to several Canadian companies. About 10 preclearance requests from foreign companies are still pending.

Experience in administering the TPM indicated the need for amending the Customs Regulations and revising the special summary steel invoice (SSSI) needed to enter imported steel mill products. Accordingly, in March 1979, Customs published a final rulemaking in the Federal Register increasing the minimum monetary reporting requirement for the SSSI and requiring the name of the producer of the steel to be shown on it. In addition, if the international transaction bringing the steel to the United States is between related parties, the resale price to the first unrelated purchaser in the United States must be shown on the SSSI. In related-party transactions this resale price is critical for comparison with the trigger price. The use of the revised SSSI became effective for shipments exported after May 7, 1979.

Countervailing duty.—In fiscal 1979, Customs initiated 16 countervailing duty investigations and made 24 final determinations, 12 affirmative and 12 negative.

The Trade Act of 1974 authorized the Secretary of the Treasury to waive the imposition of countervailing duties through January 3, 1979. On April 3, 1979, however, the President signed into law a bill extending the effective date of any countervailing duty waiver still in effect on January 3, 1979.

Miscellaneous

Customs prepared data for the district court identifying the importations and duty for both petroleum and nonpetroleum products to isolate duty that should revert to the Virgin Islands.

Customs played an important part in the moving of Alaskan oil to the lower 48 States. A court ruling upheld Customs' position that transporting Alaskan crude oil on foreign-flag vessels from Alaska to the U.S. Virgin Islands, and later shipment of products refined from the crude to the continental United States, was not a violation of coastwise laws. Customs helped prepare the Government's defense in the suit brought by the American Maritime Association.

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Merchandise Processing

Automated merchandise processing system

The automated merchandise processing program is designed to improve merchandise processing. Approximately 3,000 entries and 10,000 collections are being processed each day.

The processing system operated successfully in nine major locations, providing immediate delivery control, entry screening, and collection processing. The system improves the quality of entry processing by automatically handling routine entries assigned to it by import specialists, while permitting import specialists more time on complex entries. As a result, 19 percent (710,000) of all customs entries are being processed on this system.

The collection processing portion of this system was designed to function independently. Customs implemented the system in 45 additional locations accounting for 49 percent ($3.8 billion) of all customs collections. At present, automation supports 75 percent ($5.6 billion) of all customs collections.

In addition, Customs developed a broker interface system to provide an automated link between customs brokers/importers and the customs entry processing system. The system will reduce the number of terminal operators needed to process entries, and thus will permit economical expansion of the entry processing system. The new system is currently being tested in Baltimore, with the first phase of the test period expected to run through January 1980.

Selective examination of cargo (ACCEPT)

Beginning in October 1979, Customs tested its project ACCEPT (accelerated cargo clearance and entry processing test) at Buffalo, Houston, Philadelphia, and Seattle. ACCEPT is predicated on the theory that not all cargo shipments or customs entries involve the same degree of risk, either for regulatory and contraband purposes or classification and value. At the test ports, inspection and classification and value personnel have designated certain importers or shipments to be of minimal risk, based on prior experience. An audit of the importer's records shows whether this treatment is justified. Initial evaluation of ACCEPT indicated positive benefits both for Customs and for the importing community. Accordingly, Customs has expanded the scope of the test to include the ports of Baltimore and Miami.

Air cargo manifest system

Customs developed an air cargo manifest clearance system to automate the clearing of air cargo manifests through online terminals. The system uses the AIRINC Communications Network, servicing air carriers (preparing air manifests) and manifest processing within Customs computers.

Besides reducing the workload of Customs personnel, the system will also improve cargo manifest clearance and reporting procedures at airports. The initial pilot-test, which involves three air carriers, began September 1979 at Los Angeles Airport. If successful, Customs expects the air manifest system to be expanded to other airlines nationwide.

Bonded warehouse supervision

Customs developed bond riders for two programs designed to reduce supervision in bonded warehouses. Even though reimbursable, warehouse officer positions are still counted under Federal ceiling limitations included in the civil service reform legislation. Protection of the revenue will be

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accomplished by auditing techniques and unannounced visits by Customs inspectors to check inventories. The bond riders increased the liability of warehouse proprietors under both programs. In exchange for increased liability, the warehouse proprietors received less physical supervision over their daily operations.

Import oil control

During fiscal 1979, Customs completed a study of its operational, technical, and legal controls over imported petroleum products. Experienced managerial personnel, acting as a task force, surveyed all major oil import locations. The survey teams found that Customs monitors or witnesses the measurement of petroleum and that oil import statistics were reliable. As a result of the task force recommendations, Customs has developed uniform procedures and standards for its oil operations and has proposed appropriate changes in its regulations regarding discrepancies and public gaugers (19 CFR sections 4 and 151). In addition, Customs has developed a new procedures manual for oil importations.

Quotas

One of the principal uses of vital trade statistics is to establish commodity quotas. Customs currently enforces 940 such quotas. During fiscal 1979, a Customs-designed and installed automated quota system simplified work and expedited release of quota merchandise in more than 20 of the largest ports.

Quota system.—At key points throughout the United States, the online interactive quota system uses dial transmission facilities to connect local offices with the Customs National Data Center in Washington, D.C. The system provides field locations with quota data and the capability to expedite clearance of quota entries. Quota activity reporting is a major feature.

The new system provides the detailed quota control, reporting, file maintenance, and update functions of its predecessor. In addition, the system features include a nationwide query capability, immediate tracking and reporting of special interest items, direct field interface with nationwide quota files, online file maintenance and interactive error correcting, and audit trails of transactions with special reporting.

In 1979, among the activities Customs incorporated into the quota system were the oil importations system and agriculture licensing system. The oil importations system provides the Department of Energy with data on oil importations transactions.

Regulatory audit

The regulatory audit program is part of a broad-based Customs effort to modernize and simplify the processing of commercial transactions. The purpose of the program is to improve the revenue-producing function in addition to protecting both the revenue and the importing public. Regulatory audit's objective is to provide Customs with an external audit capability to verify transactions and claims of importers, carriers, and exporters. This will be accomplished by means of onsite audits of their records, accounts, statements, and operating facilities in lieu of more costly physical control or other means of verification.

Field audits resulted in recovered revenues for the Treasury and importing public in excess of $12 million as detailed below:

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Type of audit	Number of audits	Amount recovered
Consumption	23	$1,511,000
807	31	5,896,000
Drawback	331	2,170,000
Containers	177	8,000
Brokers	159	209,000
Other	154	2,369,000
Total	875	12,163,000

Passenger Processing

To speed inspection of law-abiding travelers and to facilitate detection of law violators, Customs relies on selectivity to identify those most likely to defy the law—companies as well as individuals. The primary tool in selectivity strategy is the Treasury enforcement communications system (TECS). Also, Customs implemented on August 8, 1978, an agreement with the Immigration and Naturalization Service and the Animal and Plant Health Inspection Service which led to the introduction in fiscal 1979 of the one-stop and citizens bypass systems at selected international ports of entry. These systems are designed to facilitate the processing of passengers.

Treasury enforcement communications system

TECS is a computerized information and communications network which provides immediate information to aid customs officers in detecting violations of customs and related laws; enforcement figures to evaluate programs and performance; statistics to determine optimum allocation of equipment, dollars, and personnel; and data that Customs can analyze to produce intelligence on violation patterns, modus operandi, and courier profiles.

To increase the effectiveness of the system, Customs drafted a report on enforcement selectivity, and developed a TECS master plan; TECS managers completed development work and programming for a streamlined passenger processing system and an improved automated index to Customs enforcement files; and a report generator was developed enabling headquarters users to formulate data requirements on TECS terminals and receive special reports from the data base without human intervention.

The TECS data base contains nearly 2 million records. The Privacy Act of 1974 demands that records be accurate, relevant, and complete. To meet the requirements, Customs personnel began a thorough data base review that resulted in a purge of all records that failed to meet those criteria.

In May 1978, the Commissioner of Customs and the Commissioner of the Immigration and Naturalization Service (INS) signed an agreement to incorporate INS Service Lookout Records (Soundex) into TECS. The inspector is able to receive INS lookouts as well as TECS, National Crime Information Center (NCIC), and other records in TECS by making one query on the primary TECS terminal. Initially introduced at land border ports, this capability was later expanded to include airports. To evaluate the effectiveness of the TECS/Soundex interface, Customs monitored the weekly Soundex matches for land border ports and airport preclearance sites during fiscal 1979 with excellent results. The interface produced a total of 1,004 hits—718 at land borders, and 286 at U.S. airports and preclearance sites.

In fiscal 1979, TECS led to the seizure of more than $200,000 in monetary instruments, more than $750,000 worth of merchandise, more than 19 pounds of heroin, 140 tons of marijuana, 750 pounds of hashish, and 300,000

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amphetamines. On the street, the drugs would have been worth more than $500 million. Alerted by TECS-NCIC, customs officers recovered 600 stolen vehicles and apprehended more than 1,300 fugitives wanted by other agencies in fiscal 1979.

At the request of the Customs International Operations Division, customs officers familiar with TECS went to Thailand and Saudi Arabia to assist those countries in the development of enforcement-related computer applications.

Citizens bypass

Under this system, U.S. citizens carrying valid passports, and military personnel traveling under official orders, are allowed to bypass Immigration processing and proceed directly to the Customs area after receiving their baggage. The system, considered the first phase of "one-stop," was installed at 23 terminals at 17 airports during fiscal 1979.

One-stop

Under the one-stop system, all air passengers arriving in the United States bypass Immigration processing and proceed directly to the Customs area after receiving their baggage. The inspectors from the different inspectional services are trained to perform certain primary functions for each agency.

One-stop is currently operating at Philadelphia International Airport only. However, Customs is urging all airport managers to consider one-stop when constructing new facilities or renovating existing ones. Construction has begun at the Los Angeles and Houston airports. Studies have shown that with accelerated airport baggage handling, Customs inspection can be speeded by as much as 20 percent.

Motor vehicle inspection

On December 4, 1978, T.D. 78–478 revised Customs procedures relating to the entry into the United States of motor vehicles and motor vehicle equipment subject to Federal motor vehicle safety standards. These changes, predicated on a 3-year survey by Customs and the National Highway Safety Traffic Administration of comments and suggestions from the public, clarified regulations on importing motor vehicles and simplified Customs enforcement of provisions of the National Traffic and Motor Vehicle Safety Act.

Enforcement

Interdiction program

Customs' tactical interdiction program combats smuggling activity along the national borders by reducing the smugglers' options for choosing the method, time, and place to attempt to enter contraband into the United States. This mobile interdiction force is capable of operations on land, sea, and in the air.

Air interdiction.—In fiscal 1979, there were six air support branches located at military airbases near San Diego, Tucson, El Paso, San Antonio, New Orleans, and Miami.

An agreement was completed with the U.S. Air Force for the loan of four T–39 high-performance jet aircraft. Customs is continuing to use the North American Radar Defense/Federal Aviation Administration (NORAD/FAA) long-range radar as well as mobile ground-based radar units for smuggling detection and tracking. A special team at Tinker Air Force Base is cooperating with AWACS (airborne warning and control system) training

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flights using this radar system to identify smugglers. Moreover, to increase its effectiveness Customs is using intelligence information on suspect aircraft available through the Treasury enforcement communications system; data from the private aircraft reporting system (PARS), which requires all private aircraft crossing the Southwest border to give at least a 15-minute advance report before penetrating U.S. airspace and to land at 1 of 14 specifically designated airports adjacent to the Mexican border; and the private aircraft inspection reporting system (PAIRS), which automates the arrival reports of all general-aviation aircraft coming from foreign countries and clearing U.S. Customs. Such arrival information is entered in TECS.

The combination of these elements enables Customs to concentrate on high-risk aircraft by screening out legitimate private aircraft.

During fiscal 1979, the air support program seized 45 vehicles, 64 aircraft, 207,240 pounds of marijuana, 1,350 pounds of hashish, 52 pounds of cocaine, 14 vessels, 18 weapons, and $74,620 in cash, and resulted in 234 arrests.

On March 12, 1979, a Customs aircraft detected the vessel Olaug 30 miles east of the eastern shore of Virginia and entered a lookout in TECS. The result was the largest hashish seizure ever made—over 41,000 pounds.

Customs/Drug Enforcement Administration (DEA) integrated airport program.—In 1978, Commissioner Chasen and DEA Administrator Bensinger signed an agreement for a Customs/DEA integrated airport program gaining maximum Customs and DEA effectiveness in interdicting narcotics carried by arriving air passengers and in cargo. The program consists of three phases: A pretraining factfinding survey conducted onsite by DEA and Customs representatives at selected airports (Phase I); a joint enforcement awareness seminar for DEA and Customs personnel at the airport (Phase II); and implementation of operational techniques and procedures programs (Phase III). Phases I and II have been completed, and DEA and Customs staffs have developed a plan for Phase III.

Land and marine interdiction.—Land and marine interdiction units have greatly improved efforts to suppress smuggling. Customs conducted two special marine operations using new strategies, tactics, and interagency cooperation to identify smuggling activities in the earliest stages of development, determine targets for intensified surveillance, and conclude interdiction operations with the greatest degree of success possible. These operations were directed mainly at the interdiction of small craft, freighters, and fishing and shrimping vessels.

Operation Gulfnet 79, conducted in the Miami region, resulted in a seizure of 370,756 pounds of marijuana valued at $110.8 million, 2 aircraft, 15 vehicles, 16 vessels, and 122 arrests. Customs officers found sophisticated electronic equipment and automatic weapons on several vessels seized.

Nationwide, there were a number of narcotic-related seizures aboard vessels. Of these seizures, 620 were marijuana totaling nearly 3 million pounds valued at $69.6 million; 48 involved 265 pounds of cocaine valued at $68.6 million, and heroin valued at $704,644.

Intelligence

Customs intelligence material was distributed throughout the world in fiscal 1979. The United Nations and the international Customs Cooperation Council circulated illustrated U.S. publications on disguised weapons, airline tickets, cans used to conceal contraband, false-bottom suitcases, and hashish smuggling.

Customs intelligence and liaison efforts also resulted in increased cooperation with the DEA, the Central Intelligence Agency, and the EL Paso

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Intelligence Center (EPIC) staffed by DEA, Customs, the Immigration and Naturalization Service, the Bureau of Alcohol, Tobacco and Firearms, and the Federal Aviation Administration. During the year, Customs expanded participation in EPIC and the DEA Interagency Drug Intelligence Group-Mexico (IDIG-M). Six customs patrol officers and four intelligence research specialists joined the EPIC staff. Customs also contributed a senior officer to the functional management of EPIC. Under the IDIG-M framework at DEA headquarters, a formal mechanism was established for the dissemination of DEA reports deemed pertinent to customs violations.

Customs introduced a major innovation, the narcotics intelligence priority (NIP) concept. NIP is a concentrated collection and dissemination effort by Customs, DEA, and EPIC targeting a specific threat—cocaine. New awareness of the cocaine problem by customs officers contributed to a 33-percent increase in cocaine seizures between fiscal 1978 and 1979.

During fiscal 1979, the reports analysis unit designed and implemented an improved format for intelligence analyses, and a manual index to correlate individuals and business firms in currency analyses. It developed and tested an effective strategy for identifying potential tax and currency violators using reports required under the (Foreign) Bank Secrecy Act. The financial unit completed 8 intelligence analyses that identified 925 currency/narcotic suspects responsible for at least $186 million in transactions that violated the law.

Investigative activity

Customs maintains a force of 640 special agents stationed at 66 domestic and 8 foreign offices. This professional investigative arm of the Customs Service has sole responsibility for investigating violations of customs and related laws and regulations. These include criminal, civil, and factfinding investigations covering 33 separate categories of cases.

In fiscal 1979, Customs redirected its efforts to give highest priority to cases of fraud, currency reporting and neutrality violations, cargo theft, dumping, countervailing duty, and smuggling. Of the 23,608 investigative cases closed during fiscal 1979, more than three-quarters fell in those high-priority categories, plus cases involving navigation violations, customhouse licenses, petitions for relief, and investigations for other departments and agencies.

Fraud.—Customs fraud is white-collar crime committed on an international scale. Violations of customs law adversely affect balance of trade, domestic industry, American labor, and U.S. trade policies. Customs puts a high priority on investigation of fraud cases which have a high potential for criminal and civil prosecution and recovery of revenue.

Currency reporting violations.—In fiscal 1979, Customs continued to emphasize the importance of intelligence and cooperation with other agencies in uncovering currency reporting violations. "Cash flow" groups were established in Los Angeles, Calif., and Blaine, Wash., in addition to a group established earlier in Miami, Fla.

Terrorist contingency planning

In May 1979, the Commissioners of the U.S. Customs Service and of the Immigration and Naturalization Service agreed that joint antiterrorism contingency planning should be undertaken because of the continuing rise of terrorist activity. This planning has resulted in detailed contingency plans for personnel of the Federal inspection agencies prescribing actions for bomb threats, actual bombing, terrorist attack, hostage taking, and other emergency conditions.

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Civil disorder contingency planning

The Commissioners of Customs and INS agreed jointly to establish contingency plans to handle civil disorders at ports of entry owned or operated by the Federal inspection agencies. This planning calls for coordinated action by regional commissioners of the Federal border inspection agencies, the U.S. Marshals Service, the Federal Bureau of Investigation, and various offices of the U.S. Attorney.

Detector dog program

During fiscal 1979, Customs' 122 detector dog teams screened more than 190,000 vehicles, aircraft, and vessels; 35 million pieces of international mail; and 18 million pieces of baggage and imported merchandise entering this country at 40 ports throughout the United States. The teams made more than 6,000 seizures of narcotics and dangerous drugs, including 10,949 pounds of marijuana, 1,870 pounds of hashish, 181 pounds of cocaine, and almost 7 pounds of heroin.

International Matters

Saudi Arabian assistance project

In June 1978, the U.S. Customs Service implemented a Customs Project Agreement to provide technical, managerial, training, and manpower development assistance to the Saudi Arabian Department of Customs under the auspices of the United States-Saudi Arabian Joint Commission on Economic Cooperation.

The objectives of the U.S. Customs technical assistance programs are to modernize and improve the efficiency of the Saudi Arabian Customs Service and to promote the transference of technology and the sale of U.S. goods and services to Saudi Arabia. U.S. Customs worked toward these objectives through training and development programs carried out under the Customs Project Agreement between the Saudi Arabian Ministry of Finance and National Economy and the U.S. Department of the Treasury. U.S. Customs worked closely with the Office of Saudi Arabian Affairs, Office of the Assistant Secretary (International Affairs), and the United States-Saudi Arabian Joint Commission on Economic Cooperation in carrying out its responsibilities under the agreement which provides for cooperation between U.S. Customs and Saudi Customs in the areas of management, technical training, and manpower development assistance. Under the terms of the agreement, Saudi Arabia finances all phases of the project, which include training Saudi customs officers in Riyadh, Saudi Arabia.

Customs Cooperation Council

U.S. Customs' active participation in the Customs Cooperation Council (CCC), an 87-member intergovernmental body with headquarters in Brussels, contributed to a number of advancements of benefit to the international community.

The Council, during fiscal 1979, adopted three new technical annexes to the International Convention on the Simplification and Harmonization of Customs Procedures, bringing the total number of annexes adopted to 26. Each annex covers a specific customs procedure or operation. Upon completion, the Convention will include 28 annexes covering the whole range of customs activities.

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Work continued on development by the CCC of a harmonized commodity description and coding system of importance to both U.S. Government agencies and private industry. Through its chairmanship of the U.S. delegation to the Harmonized System Committee, charged with drawing up the new code, U.S. Customs helped the CCC advance toward this goal.

The Council, in conjunction with ICOP/Interpol, sponsored a seminar on the training and use of narcotics detector dogs. U.S. Customs demonstrated its detector dog program before the representatives of 31 countries.

Customs continued to provide an observer to the Chemists Committee of the Customs Cooperation Council in fiscal 1979. Customs chemists completed technical review of several chapters of the Council's developing Harmonized System of Customs Procedures, contributing to the resolution of intricate problems in the chapter relating to rubber and rubber products.

TIR Convention

Customs continues to recommend accession of the United States to the 1975 Customs Convention on the International Transport of Goods under cover of TIR Carnets (TIR Convention). An updated version intended to supersede the 1959 TIR Convention, the 1975 TIR Convention contains new administrative provisions to keep pace with the latest developments in shipping and transportation. This Convention is now before the Senate Foreign Relations Committee.

International training activities

Under the auspices of the Department of State's Bureau of International Narcotics Matters, Customs continued to provide enforcement training to foreign customs officers. The programs, organized and conducted by the Foreign Operations Staff, help developing nations, especially those known to produce, manufacture, and ship illegal drugs, improve their customs officers' proficiency.

Three course development instructional techniques programs Customs conducted abroad in fiscal 1979 aided the nations involved in attaining self-sufficiency. In addition, more than 500 foreign customs officers attended 2-week enforcement courses conducted in 10 different countries.

In addition, Customs conducted other training programs within the United States. Five representatives from five nations participated in a 3-week executive observation program; representatives from several nations participated in three midmanagement seminars at Customs headquarters (more than 50 midlevel officers attended the seminars, representing 3 regions of intense narcotics activity: Latin America, Southeast Asia, and the Near East); and representatives of eight nations participated in 3-week dog trainer and 14-week detector dog handler courses at Front Royal, Va.

Management

Equal opportunity

During fiscal 1979, the Equal Opportunity Staff, working with all levels of management, implemented Customs affirmative action programs. Headquarters and three regions held equal opportunity training seminars for managers and supervisors designed to acquaint all employees with the Hispanic and Federal Women's programs.

An automated data system for tracking equal opportunity progress by compiling statistical data was designed and has produced reports showing the statistical posture of equal opportunity program efforts. Customs monitored

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the number of minorities and women employees hired and promoted for special agent, customs patrol officer, inspector, and import specialist positions.

Customs has increased the staffing of the servicewide equal opportunity program. This includes full-time Federal Women's and Hispanic program coordinators now on board, either one or both, in all regions. A complaints investigator's unit has been established to speed up the processing of discrimination complaints.

Economic analysis support

The Office of Economic Analysis, created in fiscal 1979, provides economic information, analyses, and policy advice to the Commissioner and his staff on issues affecting the Customs Service.

During fiscal 1979, the Office analyzed the potential economic impact of changes in various laws, rules, and regulations that govern U.S. international commerce, including the Customs Procedural Reform and Simplification Act, the Trade Agreements Act of 1979, proposed changes in procedures for the overtime payment of inspectors, and changes in the appraisement procedure of products entering the United States from foreign trade zones. In addition, a study on productivity and resource allocation in the Customs Service was completed.

The Office also studied developments with more widespread impacts, including U.S. export trends and trade in the products of such import-sensitive industries as television, steel, and the automobile industries.

Data processing

Integration of data processing functions.—In August 1979, Customs consolidated its headquarters data processing into the new Office of Data Systems with three divisions: Automatic Data Processing, Automated Merchandise Processing System (AMPS), and Law Enforcement Systems.

ADP dispersed processing.—Early in fiscal 1979, local data processing capabilities in each Customs region were upgraded with Datapoint 6600's, in response to requests from the regions for increased automated support. Previously, the regional systems included payroll, personnel, and accounting functions. The expanded capability permits further development of budget, inventory, work measurement, mail entry, and data retrieval. In the final quarter of fiscal 1979, a plan was begun to identify and assign priorities to applications to be implemented on the Datapoints during fiscal 1980.

Training support

Customs Academy.—In April 1979, technical training for customs patrol officers, inspectors, and import specialists was terminated at the Customs Academy in Washington, D.C., and transferred to the Federal Law Enforcement Training Center (FLETC). The Nationwide Training and Career Development Branch was moved to Customs headquarters where new career development programs are being implemented.

Cross-training with INS.—The Commissioners of Customs and the Immigration and Naturalization Service have signed an agreement which provides cross-training between their field officers. This agreement provides the INS with 16 hours of training on Customs regulations and procedures. The initial phase, field cross-training of more than 2,500 INS personnel by Customs, has been completed. The continuing requirements are being met during formal classes at the FLETC.

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UNITED STATES SAVINGS BONDS DIVISION

In support of President Carter's Government reorganization efforts, the Savings Bonds Division completed a field reorganization which reduced the number of regional offices from 7 to 6 and consolidated 42 State-level offices of varying sizes into 25 balanced sales districts. The benefits of the new organization include: Standardizing the role, grade level, and span of control of field supervisors; shortening the chain of command in key urban areas; and allocating staff resources better and improving cost-effectiveness.

In January 1980, series E and series H bonds will be replaced by two new series of savings bonds designated "series EE" and "series HH." The replacements will provide improvements and cost-effectiveness to bond buyers and the Treasury, as well. Those features such as competitive interest rate, absolute safety, and tax advantages which have made savings bonds popular over the past 40 years will remain unchanged.

In addition to directing the implementation of the reorganization and the planning for introduction of the new bonds, the National Director and other senior officials of the Division conducted active speaking schedules on behalf of the savings bonds program. Normal supervisory functions over the Division and its programs, discussed in the following sections, were conducted.

During 1979, the Savings Bonds Division continued its normal responsibilities for promoting the sale and retention of U.S. savings bonds. A staff of approximately 425 Treasury employees was augmented by an estimated force of 600,000 volunteers. These men and women organized bond drives in their industries, spoke at bond rallies, wrote and produced advertisements for bonds, or performed other sales and promotional activities.

Bond sales in fiscal 1979 totaled $7.4 billion. Series E and H bonds outstanding total approximately $80.8 billion.

Savings bonds remain one of the cornerstones of Treasury's debt management program. They are held significantly longer than marketable debt instruments and their widespread ownership—members of approximately one-third of all households hold them—is also important.

U.S. industrial payroll savings campaign

The U.S. Industrial Payroll Savings Committee, composed of 66 top business and industrial leaders, is a principal force behind the payroll savings program for industry and a major reason why E bond sales of $25 to $200 denominations have risen to over $5 billion annually.

Harold J. Haynes, chairman of the board, Standard Oil Co. of California, and chairman of the 1979 U.S. Industrial Payroll Savings Committee, began the yearly campaign with a meeting in Washington, D.C., on January 10. The luncheon meeting was highlighted by a speech from Secretary Blumenthal and reports by outgoing Committee Chairman Charles J. Pilliod, Jr., and incoming Chairman Haynes.

Members of the U.S. Industrial Payroll Savings Committee conduct meetings of top management people, urge chief executives in their areas and industries to conduct payroll savings drives, and set strong examples by conducting campaigns in their own companies.

Chairman Haynes contributed much of his own time and effort to the program. He traveled to 19 cities and addressed 20 meetings of business and community leaders between January 10 and March 1. He also provided some excellent sales tools for savings bonds volunteers, including a brochure for top executives entitled "Take Stock in America," three newsletters to the

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volunteers to publicize the campaign, and a full-page ad in the Wall Street Journal featuring the 1979 Committee members.

Financial institutions support

A major factor in the growth of savings bonds sales has been support from the Nation's financial institutions. Banks, savings and loan associations, and other institutions provide more than 39,000 over-the-counter sales outlets. They also issue bonds for many companies offering the payroll savings plan.

In 1979, American banks and bankers sent nearly 10 million letters recommending bonds to their customers and mailed nearly 50 million promotional leaflets as enclosures with bank statements.

Banks and other financial institutions also sponsored many bond newspaper advertisements. A special banker-to-banker advertisement featuring John D. Chisholm, chairman of the American Bankers Association Savings Bonds Committee, ran in national and regional trade magazines. In addition, the Secretary's message to bankers appeared in the industry's daily publication.

These promotional efforts were spearheaded by the American Bankers Association (ABA) Savings Bonds Committee, chaired by Mr. Chisholm, president of the Marquette Bank & Trust Co., Rochester, Minn. In 1979, Mr. Chisholm was the keynote speaker at numerous State bankers association conventions and "Take Stock in America" campaigns.

During 1980, the ABA Savings Bonds Committee will continue to encourage bankers to support savings bonds through a five-point banking program of bank letters, bank leaflets, bank sponsorship of ads, bank savings bonds seminars, and the establishment of payroll savings programs in banks. This is in addition to providing important assistance during the transition to the new series EE and HH bonds.

Volunteer activities

State and county volunteers are the grassroots "mainstay" of the savings bonds program. Governors, appointed by the Treasury Secretary, serve as honorary chairmen of their States, while a working State chairman and his committee provide direction. At the local level, more than 3,000 county chairmen coordinate savings bonds activities.

Richard B. Sellars, former chairman and chief executive officer, Johnson & Johnson, was national chairman, Volunteer State Chairmen's Council and State chairman for New Jersey. While presiding at the Council meeting in Washington, D.C., on November 15 and 16, 1978, Mr. Sellars encouraged State chairmen to hold payroll savings campaigns in their own companies as the first step in a comprehensive 1979 program. Mr. Sellars also traveled extensively, early in 1979, to help kick off campaigns in "Take Stock in America" Centers throughout the country. To help identify important areas of activity during the year, he published, for top volunteer leaders in every State, a special brochure containing information on bond program history and sales since 1941, as well as an action plan for volunteers. Newsletters throughout the year kept the Council up to date on 1979 campaign efforts.

A special kit of materials, "A Program for the Nation's Volunteers," was distributed and included suggested proclamations for State and local governments, sample speeches, radio and TV scripts, and other information materials.

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National organizations

In cooperation with the National Organizations Committee, chaired by Louis B. Clark, economics director of the American Legion, national associations were called upon to promote savings bonds in every local community where they have chapters. Letters of endorsement were distributed to local chapters by the organizations. Savings bonds ads and articles were run in the publications of national associations, and local chapters conducted special savings bonds meetings and developed bond exhibits for display in banks, schools, libraries, and meetingplaces. Organizations with memberships totaling 50 million supported the program.

In May, letters signed by the National Director, U.S. Savings Bonds Division, were sent to national associations asking their help in publicizing the new series EE and HH bonds. As a result, product information was distributed at conventions of organizations such as Kiwanis, the Loyal Order of Moose, the American Legion, and the Masons. Other associations agreed to run articles in their magazines and to make mailings to their membership.

Parents of babies born in hospitals that are members of the American Hospital Association received a special savings bonds message in the form of a measuring chart designed for retention and later use. Approximately 2,500,000 of these charts were distributed through hospitals in 1979.

Labor support

The National Labor Committee, under the chairmanship of George Meany, president of the American Federation of Labor and Congress of Industrial Organizations, continued its strong support for the savings bonds program. The American labor movement cooperated by promoting the sale of savings bonds to a membership of approximately 22 million organized workers, or one-fourth of the U.S. work force.

Leadership for labor support of savings bonds is provided by the six members of the above-mentioned committee. These nationally known labor leaders receive appointments from the Secretary of the Treasury to serve on the standing committee. The endorsement, cooperation, and influence of this body has promoted in a positive and effective manner the savings bonds message. Nine national labor organizations were honored during 1979 for their outstanding support of the bond program.

A marked increase in involvement by national and local union leaders was noted during 1979. This took the form of letters to members urging participation in the payroll savings plan, an increase in ads and editorials in the labor press, and the increased use of labor posters and leaflets by labor unions. To date over 1 million letters, 91,000 leaflets, and numerous ads and articles in union publications have supported the bond program. To expand the cadre of labor volunteers, a special labor kit was prepared and sent to the 450 staff and field representatives of the Community Services Department of the AFL-CIO for their use in promoting the savings bonds program at the community level.

Federal payroll savings campaign

The 1979 Federal campaign was officially kicked off on April 11 at the Departmental Auditorium. More than 2,000 top Government officials, agency bond chairpersons, and canvassers assembled for this rally. The 1979 Interagency Savings Bonds Committee Chairman Ray Marshall, Secretary of Labor, presided. The program featured the 1979 honorary chairman, three-time heavyweight champion of the world, Muhammad Ali.

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The 1979 Federal campaign was once again endorsed by President Carter in a February 22 memorandum to the heads of executive departments and agencies. He pointed out the importance for individuals of the savings bonds program "* * * as a safe and convenient means by which to save" and for the Government and country in "* * * helping to protect the value of the dollar and stabilize our nation's economy."

During calendar 1979, over 210,000 Federal Government workers either enrolled for the first time in the payroll savings plan or increased their existing allotments. The results indicate that employees of the Federal Government recognize the U.S. savings bonds program as a convenient and secure method for personal saving.

Six Federal agencies continue to maintain participation in excess of 75 percent: Tennessee Valley Authority, Department of the Treasury, Railroad Retirement Board, International Boundary and Water Commission, Defense Civil Preparedness Agency, and American Battle Monuments Commission.

Advertising support

The public service advertising campaign for savings bonds, conducted in cooperation with The Advertising Council, was well received by all media. The council estimated that close to 30,000 ads were published in newspapers, and 264,000 lines appeared in national magazines.

The Nation's television stations broadcast an estimated 130,000 savings bonds announcements during the year, while radio stations used some 465,000 public service messages for savings bonds.

Following announcement of the new 6½ percent interest rate in June, special newspaper and magazine ads and radio and television announcements were prepared. A special distribution of outdoor posters was arranged, which generated orders for more than 1,000 posters.

The general advertising campaign continued its focus on ways in which Americans use savings bonds to enrich their lives. Created by the Leo Burnett Co., volunteer taskforce agency of the council, the ads continue to use the general theme "Take Stock In America."

In the annual savings bonds awards competition for company communicators—based on payroll savings promotion appearing in company publications in 1978—Peter L. Beltrame of Travelers Insurance Co. was named "Communicator of the Year." Presentation of awards was made May 25 by the National Director at the Main Treasury Building.

An all-new copy kit for daily and weekly newspapers, and several feature articles for newspapers, were completed, and publication of "The Bond Teller" for bank personnel and the "Savings Bonds Salute" for volunteers was continued. The pocket speech guide for volunteers, "In Which We Serve," was completely revised and updated.

Administration

The U.S. Savings Bonds Division completed the field reorganization begun in late 1978.

In keeping with the President's stated desires, all affected employees were given an opportunity to transfer to other positions within the Division in lieu of demotion or separation.

Space and equipment resources have been adjusted to reflect the changes in staffing and organizational structure.

Another achievement was the further consolidation of materials distribution functions in the National Promotional Materials Center, enabling field promotional representatives and promotional support clerical personnel to

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concentrate more fully on their primary responsibility—promoting the sale and retention of U.S. savings bonds.

Training

The Division continues to conduct an intensive training program for all sales promotional trainees. This includes a detailed 2-week indoctrination and sales course, a seminar on "Principles of Professional Salesmanship," and on-the-job training for a 1-year period.

The Division's management by objectives program remains in effect. The major emphasis in 1980 will continue on achieving results.

A major National Sales Conference on November 6-8, 1979, will help train staff and leading volunteers.

The Division continues to operate an effective upward mobility program as well as a good EEO program. A management library is provided for staff members.

During 1978-79, all participants in the executive development program prepared written individual developmental plans. Several of the participants have already completed developmental assignments and formalized training to meet both organizational and individual needs. Participants also continued planned formalized training experiences. As a result of the new Senior Executive Service Program, the Executive development program will be changed to meet organizational and individual needs.

The Division continues to offer in-house and external training for its employees.

Public affairs

The Office of Public Affairs generates media coverage of the savings bonds program, provides information to the public and press, and arranges for coverage of various bond activities. During 1979 it was particularly active in promoting the future EE and HH savings bonds.

A series of press releases and question-and-answer packets on the future bonds were prepared throughout the year and distributed to major newspapers, television programs, magazines, and radio stations. This was in addition to regular releases and articles. The same information was made available for public use. During the period of this report, more than 10,000 press and public inquiry letters were received and answered as well as 50 to 80 telephone calls a day.

The Public Information Officer made a series of press visits around the country to answer questions from media people on savings bonds. A new project, providing information to all Federal Information Centers across the Nation, was conceived, and material for this use was prepared. This is expected to reduce the number of calls to the Division's smaller field offices as well as provide better information and referral service to the public.

Speech material for the National Director, the Secretary of the Treasury, and other government officials speaking on behalf of the bond program was provided throughout the year.

Direct public information assistance was provided for the 1979 industrial payroll savings campaign, the Federal campaign for payroll savings, and the Division's semiannual National Sales Conference.

Division activity relating to responsibility for the Freedom of Information Act, the Privacy Act, and consumer affairs was also handled by the office.

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UNITED STATES SECRET SERVICE

The major responsibilities of the U.S. Secret Service are defined in section 3056, title 18, United States Code. The investigative responsibilities are to detect and arrest persons committing any offense against the laws of the United States relating to coins, obligations, and securities of the United States and of foreign governments; and to detect and arrest persons violating certain laws relating to the Federal Deposit Insurance Corporation, Federal land banks, joint-stock land banks, and Federal land bank associations. The protective responsibilities include protection of the President of the United States and the members of his immediate family; the President-elect and the members of his immediate family unless the members decline such protection; the Vice President or other officer next in the order of succession to the Office of the President, and the members of his immediate family unless the members decline such protection; the Vice President-elect, and the members of his immediate family unless the members decline such protection; a former President and his wife during his lifetime; the widow of a former President until her death or remarriage; the minor children of a former President until they reach 16 years of age, unless such protection is declined; a visiting head of a foreign state or foreign government; and, at the direction of the President, other distinguished foreign visitors to the United States and official representatives of the United States performing special missions abroad. In addition, Public Law 90-331 authorizes the Secret Service to protect major Presidential and Vice Presidential candidates, unless such protection is declined; the spouse of a major Presidential or Vice Presidential nominee, except that such protection shall not commence more than 60 days prior to the general Presidential election.

Investigative operations

Counterfeiting.—The Secret Service seized $46.2 million in counterfeit U.S. currency during fiscal 1979. The dollar amount seized represents a 152-percent increase from fiscal 1978. Losses to the public increased 13 percent from $4 million in fiscal 1978 to $4.5 million in fiscal 1979. The total amount of counterfeit currency received by the Secret Service during fiscal 1979 is $50.7 million, representing a 165-percent increase over the previous year.

Of interest is the fact that 30 percent of the $4.5 million passed on the American public originated with overseas operations.

Nine percent, or $276,252, of the notes passed on the public involved the violations of raising or altering genuine currency.

The following case summaries illustrate several counterfeit investigations successfully concluded during fiscal 1979.

Las Vegas. This investigation originated in June 1979, when a confidential source advised agents of the Service that he had been approached by three known narcotics violators wishing to obtain financing or equipment to set up a printing plant to manufacture counterfeit U.S. currency and various other documents. The informant advised that the anticipated printer was a fugitive from previous counterfeiting violations. On August 14, 1979, after intensive surveillance the plant site was raided and approximately $10 million in counterfeit $50 and $100 Federal Reserve notes being manufactured were recovered. Four suspects were arrested and charged with various State and Federal charges relating to narcotics, stolen property, and counterfeiting.

New York. This case originated in December 1978 when a confidential source advised agents of a group of individuals dealing in counterfeit $100 Federal Reserve notes. Undercover agents were introduced into the opera-

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tion. During the ensuing 2-month investigation, a title III telephonic eavesdrop was authorized. The eavesdrop, utilized with extensive surveillances and several undercover purchases of counterfeit $100 bills, resulted in the seizure of approximately $1.6 million in counterfeit notes and the arrest and conviction of eight individuals. Two of the individuals arrested are reputed organized crime "hit" men and are believed responsible for 20 killings in the New York area.

Detroit. On July 16, 1979, a confidential informant advised the Detroit office that an individual was making inquiries, and apparently acting as a middleman, regarding the sale of counterfeit $100, $50, and $20 Federal Reserve notes. Four days later, based on that information, two individuals were arrested when they sold $2.8 million of the counterfeit Federal Reserve notes to an undercover agent of the Service. A search of the residence of one of the defendants resulted in the seizure of $1,234,000 in counterfeit notes. As a result of investigative efforts on the part of Service agents, an additional $966,000 worth of counterfeit notes were recovered. The total seizure involved in this investigation exceeded $5 million and has led to the arrest of a prominent organized crime figure in the Detroit area.

Check forgery.—During fiscal 1979, the Service received 59,495 checks for investigation and made 6,457 check forgery arrests, compared with 9,409 last year.

Treasury paid approximately 694 million checks during fiscal 1979. The Service received 86 checks per million paid, or 1 check for investigation for approximately 8,070 checks paid.

An example of a check forgery investigative case follows.

Between 1974 and 1979 the Veterans Administration issued over 400 educational assistance benefits checks to 60 different payees across the United States. These checks were issued as a result of fraudulent claims submitted to VA using fictitious/counterfeit military discharge certificates. The ringleader of this scheme used 16 post-office boxes in 3 States as check addresses. Over 20 fictitious bank accounts were used in New York City to allow the fraudulent negotiation of over $150,000 of these checks. The ringleader of this scheme was arrested in New York City and later pleaded guilty in Federal court. He told agents that so many checks were being sent that he donated over $10,000 to a Chicago charity just to "get rid" of some of the checks.

Secret Service agents tracked another member of this group to Baltimore, where he was arrested and returned to New York. This man also pleaded guilty in Federal court. Additional charges are pending against other persons involved in this scheme as the investigation continues.

Bond forgery.—Bond forgery investigations decreased during fiscal 1979, with 9,624 bonds received for investigation, as compared with 10,399 last fiscal year.

During fiscal 1979, 133 persons were arrested for bond forgery, as compared with 164 persons in fiscal 1978.

During the fiscal year, the Secret Service recovered, prior to forgery and redemption, 9,455 stolen bonds with a face value of $787,070, compared with fiscal 1978 when 8,648 stolen bonds were recovered with a face value of $728,530.

The summary of a typical bond forgery investigation follows.

On April 22, 1978, 303 U.S. savings bonds with a face value of $64,400 were stolen from a private residence in Bayside, New York. The bonds were ultimately fenced in New York City and distributed to two men and two women, who proceeded to redeem the bonds from New York City to Los Angeles, Calif. Through a thorough investigation by the Secret Service, the

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source of the stolen bonds was identified along with the four forgers. The investigation culminated in the arrest of the forgers and the recovery of an additional $16,700 in U.S. savings bonds from a safety deposit box in Los Angeles. All of the defendants in this case have pleaded guilty in Federal court and are currently awaiting sentencing.

Identification Branch

The Identification Branch of the Special Investigations and Security Division serves all field offices by conducting technical examinations of handwriting, handprinting, typewriting, fingerprints, palmprints, striations on counterfeit currency, altered documents, and other types of physical evidence.

During fiscal 1979, members of the Identification Branch conducted examinations in 9,802 cases involving 829,906 exhibits. This resulted in 2,865 identifications of persons and a total of 268 court appearances to furnish expert testimony.

Organized crime

The Secret Service provides special agents to each of the 14 organized crime strike forces located throughout the United States. All information is coordinated and disseminated to Secret Service field offices by the Special Investigations and Security Division at headquarters. The agent in charge of this Division, as a member of the National Organized Crime Planning Council, participates in the establishment of targets for the strike forces. This Council, made up of representatives of all Federal law enforcement agencies, meets monthly at the Department of Justice.

Treasury Security Force

The Treasury Security Force, a uniformed branch of the U.S. Secret Service, protects the Main Treasury and Treasury Annex Buildings, and participates in providing security for the White House. It also conducts investigations involving petty larceny cases, theft, and other improper actions which take place on Treasury premises.

During fiscal 1979, the Force made 12 felony arrests, interviewed 51 persons for attempted unauthorized entry into the Treasury Buildings, and conducted 47 other investigations involving misdemeanor violations.

Protective operations

During fiscal 1979, the Secret Service provided security for 18 permanent protectees.

This included numerous foreign trips. The President and Mrs. Carter visited Guadeloupe, French West Indies, and Mexico during January 1979, and Egypt and Israel in March. During the month of June, they visited Austria, Japan, and Korea. Mrs. Carter also visited Switzerland and Italy during May 1979.

The Vice President and Mrs. Mondale visited Iceland, Norway, Sweden, Denmark, Finland, and the Netherlands during April 1979. During the latter part of August and early September, they visited Japan, China, and Hong Kong. Mrs. Mondale visited Venezuela and Brazil in March 1979, prior to the visit of the Vice President, and Yugoslavia during June.

Former President and Mrs. Ford visited Syria, Israel, Egypt, Saudi Arabia, Jordan, and Ireland in January 1979. They visited Japan during March.

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Former President Nixon visited China during September 1979. Former First Lady Mrs. Lyndon Johnson visited Mexico in January, and again in February. Mrs. Johnson also visited Greece during late April and early May 1979.

During fiscal 1979, foreign dignitary protection continued to be a major effort with 115 foreign dignitaries receiving protection. Among the visitors were the official Chinese delegation in January and February 1979, and President Sadat of Egypt and Prime Minister Begin of Israel at the Mid-East peace treaty signing in March.

The U.S. Secret Service Uniformed Division continued to provide protection for the White House, Presidential offices, the official residence of the Vice President, the Blair House when occupied by a visiting head of state, and the foreign diplomatic missions of 136 countries at 407 locations within the metropolitan area of the District of Columbia. In addition, the Uniformed Division provided protection for several diplomatic locations in New York City.

Protective research

During fiscal 1979, the Secret Service completed a major study to provide more comprehensive data for the evaluation of individuals suspected of threatening the life of the President and others protected by the Service. A thorough evaluation of this study has begun.

An automated microform retrieval system for handwriting specimens was instituted and file conversion was completed during fiscal 1979.

The Intelligence Division continued formal training sessions for Division personnel and field office agents assigned to protective research to increase understanding between headquarters and the field.

The Division implemented an advanced information retrieval system that has full-text searching capabilities in an online mode.

Secure facsimile equipment (WASHFAX) to facilitate expeditious exchange of classified information with U.S. intelligence agencies became operational during fiscal 1979.

Technical security

The Technical Security Division initiated a program of Halon fire extinguisher systems in all Secret Service "high hazard" areas.

Personnel from the munitions countermeasures section provided training to all Army explosive ordnance disposal (EOD) and several police EOD units regarding support for the Secret Service during the 1980 Presidential campaign.

The Communications and the Technical Development and Planning Divisions continued contractual work for the production of voice privacy equipment to be utilized in conjunction with present VHF communications radios.

Increased visits of protectees, both domestic and foreign, resulted in several major communications efforts. Upgrading and maintenance of field office radio, teletype, and telephone systems continued.

The Technical Development and Planning Division completed installation of a map/status system for the Uniformed Division, Foreign Missions Branch.

The Data Systems Division completed conversion of its application systems, consisting of approximately 400 programs, to the new Honeywell Level 66 computers and is currently in the process of installing the new machines. Planning is in progress for automating 25 campaign coordinating centers nationwide, in support of 1980 Presidential campaign activities.

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Liaison

Through fiscal 1979, the Liaison Division maintained personal liaison at the headquarters level with Federal law enforcement agencies, the intelligence community, and other Federal governmental agencies. The liaison duty is to assure proper coordination, communications, and exchange of information in matters relating to Secret Service protective and criminal investigative responsibilities.

The Emergency Preparedness Branch establishes, coordinates, and maintains plans to evacuate the President, Vice President, successors to the President, and visiting foreign heads of state. This Branch also performs the same function for headquarters and field office relocation sites.

The Freedom of Information Branch processed 1,146 Freedom of Information Act requests and 144 Privacy Act requests during fiscal 1979.

Administration

The Office of Administration is developing a central manual of reference, in conjunction with all operating offices, of policy and procedures germane to the mission of the Secret Service and supporting bureaus during the 1980 Presidential campaign.

Personnel

In connection with the Civil Service Reform Act of 1978, a variety of training was provided to appropriate personnel. The Senior Executive Service program for the Secret Service was developed and implemented as required by the act. Considerable progress was made toward implementing other mandated reforms.

The employee assistance program was expanded and a coordinator was hired to better assist employees through counseling and referral services. Services have been expanded in both headquarters and field offices to counsel employees with problems that affect job performance. Referrals to local community agencies are made for additional counseling and/or treatment when appropriate.

Administrative operations

The involvement of full-time safety personnel in the planning stages of various Service activities has led to an active accident prevention program. Potentially hazardous situations are reviewed and solutions are sought so that risk-taking situations are minimized, especially during protective activities. In addition, environmental evaluations are continuing at the Service's indoor firing ranges, garages, and other facilities.

A concentrated effort is being made by the Service to identify recurring needs for goods and services with the possibility of converting these needs into requirement contracts. This method of contracting, where feasible, will reduce administrative expense and time delay incident to making a separate contract or issuing individual purchase orders.

Procedures were developed for an extensive manual supply system in the headquarters of the Service which provides for better control over general office supplies and operational equipment (e.g., emergency lights, first-aid kits, film, handcuffs, etc.). Inventory records, reorder levels, issuance methods, and operating guidelines are included in the system. Also, the system has been designed in such a way that it can easily be automated if further analysis reveals the need.

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Management and organization

The feasibility of implementing an airline teleticketing/reservation system network within the Service has been reviewed. Based upon preliminary findings, a significant cost savings is expected to be realized by issuing airline tickets through the teleticketing/reservation system, as opposed to the current procedures involving exchange of Government transportation requests for airline tickets. Installation of the new system is anticipated by mid-fiscal 1980.

The Service determined that implementation of a microfiche system to reduce the escalating volume of computer printout paper used for accounting information would result in greater efficiency and cost savings. Full implementation of the microfiche system was initiated during fiscal 1979.

The Privacy Act of 1974 provides certain safeguards for individuals against invasion of their privacy by regulating the collection, maintenance, use, and dissemination of information by Federal agencies. As a result of the development and implementation of a new purge procedure for manually maintained name index systems, obsolete index material has been eliminated. Efforts have begun toward designing an automated index system that will greatly enhance the availability of information among headquarters and field components in the execution of the investigative mission of the Service.

The format and content of the Secret Service Manual, which provides policy and procedural guidance to the organization, was thoroughly reviewed during fiscal 1979. As a result of the review of this directives system, a total revision of its administrative portions was accomplished to include the development of a new numbering scheme, a new page format, a more comprehensive index, and a completely reorganized subject classification structure.

A 2-year study of U.S. Secret Service automated data processing needs has resulted in a contract for the purchase, installation, and conversion of two third-generation multiprocessor mainframe computers. These computers are expected to be fully operational and provide data processing support by the commencement of the 1980 campaign year. The expanded capacity and multiprogramming capabilities allow for the development of required new systems as well as for enhancements to existing systems. Over 70 tasks have been prioritized and scheduled for implementation on the new equipment.

Training

There were 102,023 staff-hours of training conducted by the Office of Training during fiscal 1979. In addition, 8,482 staff-hours of interagency and 12,856 staff-hours of nongovernment training were completed for a total of 123,361 staff-hours. Because of budgetary restrictions on travel, there was some decrease in training this year.

Highlights of training courses conducted follow.

An inservice course, designed to update senior special agents in the state of the profession, was given to 99 agents.

The 4-day advanced emergency care course graduated 81 participants to aid in the Service's protective and investigative missions.

Technical operations briefings, designed to provide expertise in modern technical equipment, were given to 72 special agents. These agents are able to maximize the use of camera and surveillance equipment in accordance with the latest legal and organizational policies.

There were six exercises simulating various attacks on a principal. These 1-day exercises were performed for temporary and permanent dignitary protective details.

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Protective research briefings were provided to 57 senior agents and 6 intelligence research specialists. The briefings updated agents working protective intelligence in the field and aided the intelligence research specialists in analysis and evaluation of intelligence data.

A protective detail course, designed to provide special agents assigned to the Presidential and Vice Presidential details with continuing training, was initiated this year.

Advance agent seminars were conducted for 137 agents. The program was designed to train agents in the protective procedures necessary for conducting an effective advance survey.

The shift leader course, initiated to train prospective shift leaders with skills germane to the management and supervision of a protective detail shift, was attended by 84 special agents.

Counterassault team tactics training was conducted. Emphasis was on firearms training and tactics enabling agents assigned to protective details to respond quickly and effectively to an attack by a terrorist group.

An extensive 21-week program was conducted for three K–9 explosives detection teams. This training enables the teams to detect vapors given off by all known types of explosives. These teams are primarily used in support of protective responsibilities.

Some Uniformed Division officers received countersniper training designed to enable them, working in support of protection, to neutralize the potential threat of a sniping assault upon a protectee.

To insure safe and proficient use of firearms, approximately 30,000 individual courses of fire were conducted for personnel of the Secret Service and 1,706 employees of 21 other Federal law enforcement agencies required to carry firearms. Additionally, 20 employees of other Federal, State, and local agencies were trained to be firearms instructors.

In addition, uniformed members of the Secret Service were given specialized training in 1,481 sessions to update and improve their present skills. Among the courses conducted were Blair House security seminars and Cuban mission detail briefings. In addition, inservice courses were given to Uniformed Division sergeants and officers as well as special officers assigned to the various protective details such as the Ford detail in Palm Springs, Calif.

Officials of other Federal, State, and local agencies were provided training in protective procedures with emphasis on advance work to support dignitary protection operations. Approximately 630 explosive ordnance personnel were trained. Eight dignitary protection seminars were conducted to aid 160 command-level police officers. Protective operations briefings were given to 147 midmanagement police officials. These briefings, 2 days shorter than the dignitary protection seminar, are designed for generally the same purpose, but are directed toward the line officer.

Forty-eight protective seminars were provided for Secret Service administrative personnel and other law enforcement agencies to improve skills and enhance coordination with the Service in the area of protection. Similarly, 1- to 3-day programs were offered in the area of criminal investigation.

In addition to the programmed events, the Office of Training has conducted specialized security surveys for various police agencies, directed several intraorganizational research projects, and offered individual or small group briefings when the participants' inclusion in a programmed course was impractical.

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Inspection

The Office of Inspection conducted 40 office inspections in fiscal 1979. In addition, 38 special investigations, and other indepth studies and reviews were completed.

Inspectors were diverted from their regular duties to serve as supervisors on several temporary details such as the Democratic Miniconvention, and on several occasions have been detailed as Acting Special Agent in Charge of field offices experiencing prolonged vacancies.

One inspector is currently serving as full-time coordinator in the planning of the Candidate/Nominee Protective Division for the 1980 elections. Since July 1979, two inspectors have been engaged in the preparation of an operations manual for the Candidate/Nominee Protective Division and the structuring of a 4-day orientation school for detail leaders for the candidate/nominee details.

The internal auditors conducted several audits during fiscal 1979. Included in these audits was a review of expendable materials and supplies, which resulted in improved accountability and control, as well as the addition of $2.3 million of these supplies to general ledger control. In the area of cash management, an internal audit resulted in developing internal regulations for collection of outstanding debts and procedures for writing off uncollectable accounts. Auditors also made preaward reviews of cost proposals submitted by potential contractors concerning several procurements. These reviews have been used by contracting officers as a basis for contract negotiations. In addition to the routine contract audits, a review was made of a request by one contractor for extraordinary contractual relief without consideration under Public Law 85-804. One internal auditor is also assisting in the administration of a $3.3 million cost-plus-incentive fee contract under which progress payments are being made.

Legal counsel

During fiscal 1979, the Secret Service initiated two legislative proposals. The first would create a new criminal statute making it a felony to threaten certain Secret Service protectees not presently covered under section 871 of title 18, United States Code. This proposal was based upon a recommendation of the House Select Committee on Assassinations.

The second would amend chapter 25 of title 18, United States Code by adding a new section 510 making it a crime to forge, alter endorsements on, or fraudulently negotiate U.S. obligations. The new section was needed to clarify existing law relating to these matters. The final draft of the proposal submitted to Congress incorporated certain modifications suggested by the Justice Department and the U.S. Postal Service.

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EXHIBITS

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Public Debt Operations, Regulations, and Legislation

Exhibit 1.—Treasury notes

A Treasury circular covering an auction for cash with an interest rate determined through competitive bidding is reproduced in this exhibit. Circulars pertaining to the other note offerings during fiscal 1979 are similar in form and therefore are not reproduced in this report. However, essential details for each offering are summarized in the table in this exhibit, and allotment data for the new notes will be shown in table 37 in the Statistical Appendix. During the year there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new notes.

DEPARTMENT CIRCULAR NO. 12-79. PUBLIC DEBT

Department of the Treasury,
Washington, June 14, 1979.

1. INVITATION FOR TENDERS

1.1. The Secretary of the Treasury, under the authority of the Second Liberty Bond Act, as amended, invites tenders for approximately $2,750,000,000 of United States securities, designated Treasury Notes of June 30, 1981, Series U-1981 (CUSIP No. 912827 JS 2). The securities will be sold at auction with bidding on the basis of yield. Payment will be required at the price equivalent of the bid yield of each accepted tender. The interest rate on the securities and the price equivalent of each accepted bid will be determined in the manner described below. Additional amounts of these securities may be issued to Government accounts and Federal Reserve Banks for their own account in exchange for maturing Treasury securities. Additional amounts of the new securities may also be issued at the average price to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing securities held by them.

2. DESCRIPTION OF SECURITIES

2.1. The securities will be dated July 2, 1979, and will bear interest from that date, payable on a semiannual basis on December 31, 1979, and each subsequent 6 months on June 30 and December 31, until the principal becomes payable. They will mature June 30, 1981, and will not be subject to call for redemption prior to maturity.

2.2 The income derived from the securities is subject to all taxes imposed under the Internal Revenue Code of 1954. The securities are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, any possession of the United States, or any local taxing authority.

2.3. The securities will be acceptable to secure deposits of public monies. They will not be acceptable in payment of taxes.

2.4. Bearer securities with interest coupons attached, and securities registered as to principal and interest, will be issued in denominations of $5,000, $10,000, $100,000, and $1,000,000. Book-entry securities will be available to eligible bidders in multiples of those amounts. Interchanges of securities of different denominations and of coupon, registered and book-entry securities, and the transfer of registered securities will be permitted.

2.5. The Department of the Treasury's general regulations governing United States securities apply to the securities offered in this circular. These general regulations include those currently in effect, as well as those that may be issued at a later date.

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3. SALE PROCEDURES

3.1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20226, up to 1:30 p.m., Eastern Daylight Saving time, Tuesday, June 19, 1979. Noncompetitive tenders as defined below will be considered timely if postmarked no later than Monday, June 18, 1979.

3.2. Each tender must state the face amount of securities bid for. The minimum bid is $5,000 and larger bids must be in multiples of that amount. Competitive tenders must also show the yield desired, expressed in terms of an annual yield with two decimals, e.g., 7.11%. Common fractions may not be used. Noncompetitive tenders must show the term "noncompetitive" on the tender form in lieu of a specified yield. No bidder may submit more than one noncompetitive tender and the amount may not exceed $1,000,000.

3.3. All bidders must certify that they have not made and will not make any agreements for the sale or purchase of any securities of this issue prior to the deadline established in Section 3.1. for receipt of tenders. Those authorized to submit tenders for the account of customers will be required to certify that such tenders are submitted under the same conditions, agreements, and certifications as tenders submitted directly by bidders for their own account.

3.4. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and primary dealers, which for this purpose are defined as dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, may submit tenders for account of customers if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

3.5. Tenders will be received without deposit for their own account from commercial banks and other banking institutions; primary dealers, as defined above; Federally-insured savings and loan associations; States, and their political subdivisions or instrumentalities; public pension and retirement and other public funds; international organizations in which the United States holds membership; foreign central banks and foreign states; Federal Reserve Banks; and Government accounts. Tenders from others must be accompanied by a deposit of 5% of the face amount of securities applied for (in the form of cash, maturing Treasury securities or readily collectible checks), or by a guarantee of such deposit by a commercial bank or a primary dealer.

3.6. Immediately after the closing hour, tenders will be opened, followed by a public announcement of the amount and yield range of accepted bids. Subject to the reservations expressed in Section 4, noncompetitive tenders will be accepted in full, and then competitive tenders will be accepted, starting with those at the lowest yields, through successively higher yields to the extent required to attain the amount offered. Tenders at the highest accepted yield will be prorated if necessary. After the determination is made as to which tenders are accepted, a coupon rate will be established, on the basis of a 1/8 of one percent increment, which results in an equivalent average accepted price close to 100.000 and a lowest accepted price above the original issue discount limit of 99.750. That rate of interest will be paid on all of the securities. Based on such interest rate, the price on each competitive tender allotted will be determined and each successful competitive bidder will be required to pay the price equivalent to the yield bid. Those submitting noncompetitive tenders will pay the price equivalent to the weighted average yield of accepted competitive tenders. Price calculations will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final. If the amount of noncompetitive tenders received would absorb all or most of the offering, competitive tenders will be accepted in an amount sufficient to provide a fair determination of the yield. Tenders received from Government accounts and Federal Reserve Banks will be accepted at the price equivalent to the weighted average yield of accepted competitive tenders.

3.7. Competitive bidders will be advised of the acceptance or rejection of their tenders. Those submitting noncompetitive tenders will only be notified if the tender is not accepted in full, or when the price is over par.

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4. RESERVATIONS

4.1. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders in whole or in part, to allot more or less than the amount of securities specified in Section 1, and to make different percentage allotments to various classes of applicants when the Secretary considers it in the public interest. The Secretary's action under this Section is final.

5. PAYMENT AND DELIVERY

5.1. Settlement for allotted securities must be made or completed on or before Monday, July 2, 1979, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt, wherever the tender was submitted. Payment must be in cash; in other funds immediately available to the Treasury; in Treasury bills, notes or bonds (with all coupons detached) maturing on or before the settlement date but which are not overdue as defined in the general regulations governing United States securities; or by check drawn to the order of the institution to which the tender was submitted, which must be received at such institution no later than:

(a) Thursday, June 28, 1979, if the check is drawn on a bank in the Federal Reserve District of the institution to which the check is submitted (the Fifth Federal Reserve District in case of the Bureau of the Public Debt), or

(b) Tuesday, June 26, 1979, if the check is drawn on a bank in another Federal Reserve District.

Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at the applicable Federal Reserve Bank. Payment will not be considered complete where registered securities are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. When payment is made in securities, a cash adjustment will be made to or required of the bidder for any difference between the face amount of securities presented and the amount payable on the securities allotted.

5.2. In every case where full payment is not completed on time, the deposit submitted with the tender, up to 5 percent of the face amount of securities allotted, shall, at the discretion of the Secretary of the Treasury, be forfeited to the United States.

5.3. Registered securities tendered as deposits and in payment for allotted securities are not required to be assigned if the new securities are to be registered in the same names and forms as appear in the registrations or assignments of the securities surrendered. When the new securities are to be registered in names and forms different from those in the inscriptions or assignments of the securities presented, the assignment should be to "The Secretary of the Treasury for (securities offered by this circular) in the name of (name and taxpayer identifying number)." If new securities in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon (securities offered by this circular) to be delivered to (name and address)." Specific instructions for the issuance and delivery of the new securities, signed by the owner or authorized representative, must accompany the securities presented. Securities tendered in payment should be surrendered to the Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. The securities must be delivered at the expense and risk of the holder.

5.4. If bearer securities are not ready for delivery on the settlement date, purchasers may elect to receive interim certificates. These certificates shall be issued in bearer form and shall be exchangeable for definitive securities of this issue, when such securities are available, at any Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. The interim certificates must be returned at the risk and expense of the holder.

5.5. Delivery of securities in registered form will be made after the requested form of registration has been validated, the registered interest account has been established, and the securities have been inscribed.

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6. GENERAL PROVISIONS

6.1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make allotments as directed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of securities on full-paid allotments, and to issue interim certificates pending delivery of the definitive securities.

6.2. The Secretary of the Treasury may at any time issue supplemental or amendatory rules and regulations governing the offering. Public announcement of such changes will be promptly provided.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 12-79. PUBLIC DEBT

DEPARTMENT OF THE TREASURY
Washington, June 20, 1979.

The Secretary announced on June 19, 1979, that the interest rate on the notes designated Series U-1981, described in Department Circular—Public Debt Series—No. 12-79, dated June 14, 1979, will be 9-1/8 percent. Interest on the notes will be payable at the rate of 9-1/8 percent per annum.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

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Summary of information pertaining to Treasury notes issued during fiscal year 1979

Date of preliminary announcement	Department circular No.	Department circular Date	Concurrent offering circular No.	Treasury notes issued (all offered for cash)	Type of auction[1]	Accepted tenders Average price	Accepted tenders High price	Accepted tenders Low price	Minimum denomination	Issue date	Maturity date	Date tenders received	Payment date[2]
1978		*1979*								*1979*		*1979*	*1978*
Sept. 13	22–78	Sept. 14	....	8⅝ percent Series T–1980	Yield.....	99.955	[3]99.937	100.063	5,000	Oct. 2	Sept. 30, 1980	Sept. 20	Oct. 2
Oct. 17	24–78	Oct. 18	....	8⅞ percent Series U–1980	Yield.....	99.883	[3]99.812	99.955	5,000	Oct. 31	Oct. 31, 1980	Oct. 24	Oct. 31
Oct. 25	25–78	Oct. 26	26–78,27–78	9¼ percent Series K–1982	Yield.....	99.678	[3]99.649	99.766	5,000	Nov. 15	May 15, 1982	Oct. 31	Nov. 15
Oct. 25	26–78	Oct. 26	25–78,27–78	8¾ percent Series B–1988	Yield.....	99.345	99.020	100.000	1,000	Nov. 15	Nov. 15, 1988	Nov. 2	Nov. 15
Nov. 15	28–78	Nov. 16	....	9¼ percent Series V–1980	Yield.....	99.804	[3]99.786	99.857	5,000	Nov. 30	Nov. 30, 1980	Nov. 21	Nov. 30
										1979			*1979*
Dec. 13	29–78	Dec. 14	30–78	9⅞ percent Series W–1980.....	Yield.....	99.797	[3]99.779	99.832	5,000	Jan. 2	Dec. 31, 1980	Dec. 19	Jan. 2
Dec. 13	30–78	Dec. 14	29–78	9⅜ percent Series L–1982	Yield.....	99.755	[3]99.690	99.820	1,000	Jan. 2	Dec. 31, 1982	Dec. 20	Jan. 2
1979		*1979*										*1979*	
Jan. 17	1–79	Jan. 18	....	9¾ percent Series P–1981.....	Yield.....	99.822	[3]99.787	99.876	5,000	Jan. 31	Jan. 31, 1981	Jan. 23	Jan. 31
Jan. 31	2–79	Feb. 1	3–79	9 percent Series B–1987	Yield.....	99.944	[3]99.888	100.281	1,000	Feb. 15	Feb. 15, 1987	Feb. 6	Feb. 15
Feb. 13	4–79	Feb. 14	....	9¾ percent Series Q–1981	Yield.....	99.822	[3]99.787	100.000	5,000	Feb. 28	Feb. 28, 1981	Feb. 21	Feb. 28
Feb. 21	5–79	Feb. 22	....	9¼ percent Series D–1983.....	Yield.....	99.638	[3]99.605	99.705	1,000	Mar. 5	Mar. 31, 1983	Feb. 27	Mar. 5
Apr. 2	6–79	Mar. 15	....	9⅝ percent Series R–1981	Yield.....	99.903	[3]99.868	99.938	5,000	Apr. 9	Mar. 31, 1981	Apr. 5	Apr. 9
Apr. 18	8–79	Apr. 19	....	9¾ percent Series S–1981.....	Yield.....	99.947	[3]99.929	100.000	5,000	Apr. 30	Apr. 30, 1981	Apr. 24	Apr. 30
Apr. 25	9–79	Apr. 26	10–79	9¼ percent Series A–1989	Yield.....	99.232	[3]99.168	99.296	1,000	May 15	May 15, 1989	May 1	May 15
May 16	11–79	May 17	....	9¾ percent Series T–1981	Yield.....	99.964	[3]99.964	100.000	5,000	May 31	May 31, 1981	May 22	May 31
June 13	12–79	June 14	13–79	9⅛ percent Series U–1981	Yield.....	99.830	[3]99.813	99.866	5,000	July 2	June 30, 1981	June 19	July 2
June 13	13–79	June 14	12–79	8⅞ percent Series E–1983	Yield.....	99.950	99.819	100.083	1,000	July 2	June 30, 1983	June 21	July 2
July 17	15–79	July 18	....	9⅜ percent Series V–1981	Yield.....	99.938	[3]99.866	100.045	5,000	July 31	July 31, 1981	July 24	July 31
July 25	16–79	July 26	17–79,18–79	9 percent Series M–1982.....	Yield.....	99.845	99.820	99.923	5,000	Aug. 15	Aug. 15, 1982	July 31	Aug. 15
July 25	17–79	July 26	18–79,16–79	9 percent Series B–1987	Price....	100.00	100.07	99.96	1,000	Aug. 15	Feb. 15, 1987	Aug. 1	Aug. 15
Aug. 14	19–79	Aug. 15	....	9⅝ percent Series W–1981.....	Yield.....	99.955	[3]99.938	100.045	5,000	Aug. 31	Aug. 31, 1981	Aug. 22	Aug. 31
Aug. 21	20–79	Aug. 22	....	9¼ percent Series C–1984	Yield.....	99.922	99.848	99.997	1,000	Sept. 5	May 15, 1984	Aug. 28	Sept. 5

[1] All auctions but one for issues of notes were by the "yield" method in which bidders were required to bid on the basis of an annual yield; one issue of notes was by the "price" method, in which case the interest rate was announced prior to the auction and bidders were requested to bid a price. After tenders were allotted in the "yield" method auction, an interest rate for the notes was established at the nearest one-eighth of 1 percent increment that translated into an average accepted price close to 100.000.

[2] Payment could not be made through Treasury tax and loan accounts.

[3] Relatively small amounts of bids were accepted at a price or prices above the high shown. However, the higher price or prices are not shown in order to avoid an appreciable discontinuity in the range of prices, which would make it misrepresentative.

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Exhibit 2.—Treasury bonds

A Treasury circular covering an auction of Treasury bonds for cash is reproduced in this exhibit. Circulars pertaining to other bond offerings during fiscal 1979 are similar in form and therefore are not reproduced in this report. However, essential details for each offering are summarized in the table in this exhibit, and allotment data for the bonds will be shown in table 38 in the Statistical Appendix. During the year there were no offerings in which holders of maturing securities were given preemptive rights to exchange their holdings for new bonds.

DEPARTMENT CIRCULAR NO. 14-79. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, June 21, 1979.

1. INVITATION FOR TENDERS

1.1. The Secretary of the Treasury, under the authority of the Second Liberty Bond Act, as amended, invites tenders for approximately $1,500,000,000 of United States securities, designated Treasury Bonds of 1994 (CUSIP No. 912810 CH 9). The securities will be sold at auction with bidding on the basis of yield. Payment will be required at the price equivalent of the bid yield of each accepted tender. The interest rate on the securities and the price equivalent of each accepted bid will be determined in the manner described below. Additional amounts of these securities may be issued for cash to Federal Reserve Banks as agents of foreign and international monetary authorities.

2. DESCRIPTION OF SECURITIES

2.1. The securities will be dated July 9, 1979, and will bear interest from that date, payable on a semiannual basis on February 15, 1980, and each subsequent 6 months on August 15 and February 15, until the principal becomes payable. They will mature August 15, 1994, and will not be subject to call for redemption prior to maturity.

2.2. The income derived from the securities is subject to all taxes imposed under the Internal Revenue Code of 1954. The securities are subject to estate, inheritance, gift or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, any possession of the United States, or any local taxing authority.

2.3. The securities will be acceptable to secure deposits of public monies. They will not be acceptable in payment of taxes.

2.4. Bearer securities with interest coupons attached, and securities registered as to principal and interest, will be issued in denominations of $1,000, $5,000, $10,000, $100,000, and $1,000,000. Book-entry securities will be available to eligible bidders in multiples of those amounts. Interchanges of securities of different denominations and of coupon, registered and book-entry securities, and the transfer of registered securities will be permitted.

2.5. The Department of the Treasury's general regulations governing United States securities apply to the securities offered in this circular. These general regulations include those currently in effect, as well as those that may be issued at a later date.

3. SALE PROCEDURES

3.1. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D.C. 20026, up to 1:30 p.m., Eastern Daylight Saving time, Wednesday, June 27, 1979. Noncompetitive tenders as defined below will be considered timely if postmarked no later than Tuesday, June 26, 1979.

3.2. Each tender must state the face amount of securities bid for. The minimum bid is $1,000 and larger bids must be in multiples of that amount. Competitive tenders must also show the yield desired, expressed in terms of an annual yield with two decimals, e.g., 7.11%. Common fractions may not be used. Noncompetitive tenders must show the term "noncompetitive" on the tender form in lieu of a specified yield. No bidder

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may submit more than one noncompetitive tender and the amount may not exceed $1,000,000.

3.3. All bidders must certify that they have not made and will not make any agreements for the sale or purchase of any securities of this issue prior to the deadline established in Section 3.1. for receipt of tenders. Those authorized to submit tenders for the account of customers will be required to certify that such tenders are submitted under the same conditions, agreements, and certifications as tenders submitted directly by bidders for their own account.

3.4. Commercial banks, which for this purpose are defined as banks accepting demand deposits, and primary dealers, which for this purpose are defined as dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, may submit tenders for account of customers if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

3.5. Tenders will be received without deposit for their own account from commercial banks and other banking institutions; primary dealers, as defined above; Federally-insured savings and loan associations; States, and their political subdivisions or instrumentalities; public pension and retirement and other public funds; international organizations in which the United States holds membership; foreign central banks and foreign states; Federal Reserve Banks; and Government accounts. Tenders from others must be accompanied by a deposit of 5% of the face amount of securities applied for (in the form of cash, maturing Treasury securities or readily collectible checks), or by a guarantee of such deposit by a commercial bank or a primary dealer.

3.6. Immediately after the closing hour, tenders will be opened, followed by a public announcement of the amount and yield range of accepted bids. Subject to the reservations expressed in Section 4, noncompetitive tenders will be accepted in full, and then competitive tenders will be accepted, starting with those at the lowest yields, through successively higher yields to the extent required to attain the amount offered. Tenders at the highest accepted yield will be prorated if necessary. After the determination is made as to which tenders are accepted, a coupon rate will be established, on the basis of a 1/8 of one percent increment, which results in an equivalent average accepted price close fo 100.000 and a lowest accepted price above the original issue discount limit of 96.250. That rate of interest will be paid on all of the securities. Based on such interest rate, the price on each competitive tender allotted will be determined and each successful competitive bidder will be required to pay the price equivalent to the yield bid. Those submitting noncompetitive tenders will pay the price equivalent to the weighted average yield of accepted competitive tenders. Price calculations will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final. If the amount of noncompetitive tenders received would absorb all or most of the offering, competitive tenders will be accepted in an amount sufficient to provide a fair determination of the yield. Tenders received from Government accounts and Federal Reserve Banks will be accepted at the price equivalent to the weighted average yield of accepted competitive tenders.

3.7. Competitive bidders will be advised of the acceptance or rejection of their tenders. Those submitting noncompetitive tenders will only be notified if the tender is not accepted in full, or when the price is over par.

4. RESERVATIONS

4.1. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders in whole or in part, to allot more or less than the amount of securities specified in Section 1, and to make different percentage allotments to various classes of applicants when the Secretary considers it in the public interest. The Secretary's action under this Section is final.

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5. PAYMENT AND DELIVERY

5.1. Settlement for allotted securities must be made or completed on or before Monday, July 9, 1979, at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt, wherever the tender was submitted. Payment must be in cash; in other funds immediately available to the Treasury; in Treasury bills, notes or bonds (with all coupons detached) maturing on or before the settlement date but which are not overdue as defined in the general regulations governing United States securities; or by check drawn to the order of the institution to which the tender was submitted, which must be received at such institution no later than:

(a) Thursday, July 5, 1979, if the check is drawn on a bank in the Federal Reserve District of the institution to which the check is submitted (the Fifth Federal Reserve District in case of the Bureau of the Public Debt), or

(b) Tuesday, July 3, 1979, if the check is drawn on a bank in another Federal Reserve District.

Checks received after the dates set forth in the preceding sentence will not be accepted unless they are payable at the applicable Federal Reserve Bank. Payment will not be considered complete where registered securities are requested if the appropriate identifying number as required on tax returns and other documents submitted to the Internal Revenue Service (an individual's social security number or an employer identification number) is not furnished. When payment is made in securities, a cash adjustment will be made to or required of the bidder for any difference between the face amount of securities presented and the amount payable on the securities allotted.

5.2. In every case where full payment is not completed on time, the deposit submitted with the tender, up to 5 percent of the face amount of securities allotted, shall, at the discretion of the Secretary of the Treasury, be forfeited to the United States.

5.3. Registered securities tendered as deposits and in payment for allotted securities are not required to be assigned if the new securities are to be registered in the same names and forms as appear in the registrations or assignments of the securities surrendered. When the new securities are to be registered in names and forms different from those in the inscriptions or assignments of the securities presented, the assignment should be to "The Secretary of the Treasury for (securities offered by this circular) in the name of (name and taxpayer identifying number)." If new securities in coupon form are desired, the assignment should be to "The Secretary of the Treasury for coupon (securities offered by this circular) to be delivered to (name and address)." Specific instructions for the issuance and delivery of the new securities, signed by the owner or authorized representative, must accompany the securities presented. Securities tendered in payment should be surrendered to the Federal Reserve Bank or Branch or to the Bureau of the Public Debt, Washington, D.C. 20226. The securities must be delivered at the expense and risk of the holder.

5.4. If bearer securities are not ready for delivery on the settlement date, purchasers may elect to receive interim certificates. These certificates shall be issued in bearer form and shall be exchangeable for definitive securities of this issue, when such securities are available, at any Federal Reserve Bank or Branch or at the Bureau of the Public Debt, Washington, D.C. 20226. The interim certificates must be returned at the risk and expense of the holder.

5.5. Delivery of securities in registered form will be made after the requested form of registration has been validated, the registered interest account has been established, and the securities have been inscribed.

6. GENERAL PROVISIONS

6.1. As fiscal agents of the United States, Federal Reserve Banks are authorized and requested to receive tenders, to make allotments as directed by the Secretary of the Treasury, to issue such notices as may be necessary, to receive payment for and make delivery of securities on full-paid allotments, and to issue interim certificates pending delivery of the definitive securities.

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6.2. The Secretary of the Treasury may at any time issue supplemental or amendatory rules and regulations governing the offering. Public announcement of such changes will be promptly provided.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

SUPPLEMENT TO DEPARTMENT CIRCULAR NO. 14-79. PUBLIC DEBT

DEPARTMENT OF THE TREASURY,
Washington, June 28, 1979.

The Secretary of the Treasury announced on June 27, 1979, that the interest rate on the bonds described in Department Circular—Public Debt Series—No. 14-79, dated June 21, 1979, will be 8-3/4 percent. Interest on the bonds will be payable at the rate of 8-3/4 percent per annum.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

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Summary of information pertaining to Treasury bonds issued during fiscal year 1979

Date of preliminary announcement	Department circular No.	Department circular Date	Concurrent offering circular No.	Treasury bonds issued (all auctioned for cash)	Type of auction[1]	Accepted tenders: Average price	Accepted tenders: High price	Accepted tenders: Low price	Issue date	Maturity date	Date tenders received	Payment date[2]
1978		*1978*									*1978*	
Sept. 19	23-78	Sept. 20		8 5/8 percent of 1993	Yield	99.840	[3]99.757	100.175	Oct. 10	Nov. 15, 1993	Sept. 27	Oct. 10
Oct. 25	27-78	Oct. 26	25-78,26-78	8 3/4 percent of 2003-2008	Yield	98.851	98.747	99.266	Nov. 15	Nov. 15, 2008	Nov. 2	Nov. 15
									1979		*1979*	*1979*
Dec. 27	31-78	Dec. 28		9 percent of 1994	Yield	99.963	[3]99.882	100.045	Jan. 11	Feb. 15, 1994	Jan. 4	Jan. 11
1979		*1979*										
Jan. 31	3-79	Feb. 1	2-79	8 3/4 percent of 2003-2008	Price	97.05	97.40	9.90	Feb. 15[4]	Nov. 15, 2008	Feb. 7	Feb. 15
Mar. 22	7-79	Mar. 23		9 percent of 1994	Price	98.79	[3]99.09	98.69	Apr. 18[5]	Feb. 15, 1994	Apr. 10	Apr. 18
Apr. 25	10-79	Apr. 26	9-79	9 1/8 percent of 2004-2009	Yield	98.938	98.838	99.039	May 15	May 15, 2009	May 2	May 15
June 20	14-79	June 21		8 3/4 percent of 1994	Yield	99.467	99.302	99.714	July 9	Aug. 15, 1994	June 27	July 9
July 25	18-79	July 26	16-79,17-79	9 1/8 percent of 2004-2009	Price	102.13	102.36	101.99	Aug. 15[6]	May 15, 2009	Aug. 2	Aug. 15

[1] Some issues of bonds were auctioned by the "price" method, with the interest rate being announced prior to the auction, and bidders were required to bid at a price. Other auctions were held by the "yield" method in which case bidders were required to bid at a yield. After tenders were allotted in the "yield" method auction an interest rate for the bonds was established at the nearest one-eighth of 1 percent increment that translated into an average accepted price close to 100.000.

[2] Payment could not be made through Treasury tax and loan accounts for any of the issues.

[3] Relatively small amounts of bids were allotted at a price or prices above the high shown. However, the higher price or prices are not shown in order to prevent an appreciable discontinuity in the range of prices, which would make it misrepresentative.

[4] Interest was payable from Feb. 15, 1979.

[5] Interest was payable from Apr. 18, 1979.

[6] Interest was payable from Aug. 15, 1979.

NOTE: The maximum amount that could be bid for on a noncompetitive basis for each issue was $1 million. All issues had a minimum denomination of $1,000.

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Exhibit 3.—Treasury bills

During the fiscal year there were 52 weekly issues of 13-week and 26-week bills (the 13-week bills represent additional amounts of bills with an original maturity of 26 weeks), 13 52-week issues, and 5 issues of cash management bills. A press release inviting tenders for 13-week and 26-week bills is reproduced in this exhibit and is representative of all releases except those for cash management bills. The offering press release of February 23, 1979, inviting tenders for 48-day bills is also included and is representative of all such releases. Also reproduced is a press release which is representative of releases announcing the results of offerings. Data for each issue during the fiscal year appears in table 39 in the Statistical Appendix.

PRESS RELEASE OF JUNE 19, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,900 million, to be issued June 28, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $5,915 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $2,900 million, representing an additional amount of bills dated March 29, 1979, and to mature September 27, 1979 (CUSIP No. 912793 2N 5), originally issued in the amount of $3,007 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated June 28, 1979, and to mature December 27, 1979 (CUSIP No. 912793 3B 0).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing June 28, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,506 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive tenders.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Daylight Saving time, Monday, June 25, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering; e.g., bills with three months to maturity previously offered as six month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

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Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on June 28, 1979, in cash or other immediately available funds or in Treasury bills maturing June 28, 1979. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series—Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

PRESS RELEASE OF FEBRUARY 23, 1979

TREASURY OFFERS $4,000 MILLION OF 48-DAY TREASURY BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $4,000 million of 48-day Treasury bills to be issued March 2, 1979, representing an additional amount of bills dated October 19, 1978, maturing April 19, 1979 (CUSIP No. 912793 X9 2).

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 12:30 p.m., Eastern Standard time, Tuesday, February 27, 1979. Noncompetitive tenders will not be accepted. Tenders will not be received at the Department of the Treasury, Washington. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. The price on tenders offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. Except for definitive bills in the $100,000 denomination, which will be available only to investors who are able to show that they are required by law or regulation to hold securities in physical form, this series of bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches.

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Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible for recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches, or for bills issued in bearer form, where authorized. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Those submitting tenders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately available funds on Friday, March 2, 1979.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, No. 418 (current revision), Public Debt Series—Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars may be obtained from any Federal Reserve Bank or Branch.

PRESS RELEASE OF JUNE 25, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,901 million of 13-week bills and for $3,001 million of 26-week bills, both to be issued on June 28, 1979, were accepted today.

Range of accepted competitive bids

	13-week bills: maturing Sept. 27, 1979			26-week bills: maturing Dec.27, 1979		
	Price	Discount rate	Investment rate[1]	Price	Discount rate	Investment rate[1]
High	97.781	8.778%	9.13%	[2]95.506	8.889%	9.46%
Low	97.771	8.818%	9.17%	95.492	8.917%	9.49%
Average	97.775	8.802%	9.15%	95.499	8.903%	9.48%

[1]Equivalent coupon-issue yield.
[2]Excepting 1 tender of $910,000.

NOTE. —Tenders at the low price for the 13-week bills were allotted 71 percent.
—Tenders at the low price for the 26-week bills were allotted 74 percent.

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Tenders received and accepted
[In thousands]

	Received	Accepted	Received	Accepted
Location:				
Boston	$27,500	$26,500	$52,445	$24,295
New York	4,640,735	2,404,485	5,000,225	2,742,275
Philadelphia	21,305	19,500	48,165	8,165
Cleveland	24,115	24,060	35,790	16,790
Richmond	20,805	20,755	16,030	11,030
Atlanta	26,300	24,865	20,065	19,335
Chicago	458,285	168,360	217,960	33,860
St. Louis	34,815	11,005	36,890	13,365
Minneapolis	19,970	13,100	16,295	7,295
Kansas City	23,830	23,830	21,475	19,350
Dallas	14,000	14,000	14,890	14,890
San Francisco	309,950	132,050	201,770	76,770
Treasury	18,430	18,430	13,210	13,210
TOTAL	5,640,040	2,900,940	5,695,210	3,000,630
Type:				
Competitive	4,112,185	1,373,085	4,323,445	1,628,865
Noncompetitive	386,500	386,500	241,565	241,565
Subtotal, public	4,498,685	1,759,585	4,565,010	1,870,430
Federal Reserve and foreign official institutions	1,141,355	1,141,355	1,130,200	1,130,200
TOTAL	5,640,040	2,900,940	5,695,210	3,000,630

Exhibit 4.—Department Circular No. 653, Ninth Revision, April 23, 1974, amended, offering of United States savings bonds, Series E

DEPARTMENT OF THE TREASURY,
Washington, December 21, 1978.

SUMMARY: The purpose of this amendment to the current offering of United States savings bonds, Series E, is to revise the tables of redemption values and investment yields for bonds of various issue dates entering their first or next extended maturity period.

EFFECTIVE DATE: January 16, 1979.

SUPPLEMENTARY INFORMATION: The tables contained in the offering circular for Series E savings bonds show the redemption values and investment yields for bonds of all issue dates. Each table covers particular groupings of issue dates. When the earlier dated bonds in any group reach the end of an original or extended maturity period, it is necessary to provide a supplemental table to reflect the redemption values and investment yields that will apply to their first or next extended maturity period. During 1979, the earlier dated bonds in each of the following groups will enter their first or next extended maturity period:

(1) Table 20—bonds dated June 1 through November 1, 1949;
(2) Table 21—bonds dated December 1, 1949, through May 1, 1950;
(3) Table 63—bonds dated June 1 through August 1, 1961;
(4) Table 64—bonds dated September 1 through November 1, 1961;
(5) Table 65—bonds dated December 1, 1961, through February 1, 1962;
(6) Table 66—bonds dated March 1 through May 1, 1962;
(7) Table 96—bonds dated June 1 through November 1, 1973; and
(8) Table 98—only for bonds dated January 1 through December 1, 1974.

To reflect these new extended maturity periods, Tables 20, 21, 63, 64, 65, 66, and 96 are being supplemented to show redemption values and investment yields for the first or next extended maturity period applicable thereto. It should be noted that, in some cases, later dated bonds covered by these tables will not enter their first or next

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extended maturity period until after 1979. As extensions have already been irrevocably granted to these bonds, the supplemental tables published below will apply to them, provided there is no intervening change in the interest rate paid on savings bonds.

With respect to Table 98, new Table 99 is being added to cover those bonds dated January 1, 1975, through August 1, 1976, which will not enter their first extension until a later time. Table 98, which will now only cover bonds dated January 1, 1974, through December 1, 1974, is being supplemented at this time to show the redemption values and investment yields of these bonds for their first extended maturity period. These are the only bonds covered by former Table 98 that will enter an extension during 1979.

Accordingly, Department of the Treasury Circular No. 653, Ninth Revision, as amended, Dated April 23, 1974 (31 CFR, Part 316) is hereby further amended by the deletion of current Table 98 and the issuance of new Tables 20-A, 21-A, 63-A, 64-A, 65-A, 66-A, 96-A, 98, 98-A and 99.

The foregoing amendment was effected under authority of Section 22 of the Second Liberty Bond Act, as amended (49 Stat. 21, as amended; 31 U.S.C. 757c) and 5 U.S.C. 301.

Since this amendment involves the fiscal policy of the United States and does not meet the Department's criteria for significant regulations, it has been determined that notice and public procedures thereon are unnecessary.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

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TABLE 20-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1949

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1000.00			
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)*							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
	THIRD EXTENDED MATURITY PERIOD									
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/79)	$25.88	$64.71	$129.42	$258.84	$517.68	$1294.20	$2588.40	----	6.00	6.00
0-6 to 1-0 . . . . (12/1/79)	26.66	66.65	133.30	266.60	533.20	1333.00	2666.00	6.00	6.00	6.00
1-0 to 1-6 . . . . (6/1/80)	27.46	68.65	137.30	274.60	549.20	1373.00	2746.00	6.00	6.00	6.00
1-6 to 2-0 . . . . (12/1/80)	28.28	70.71	141.42	282.84	565.68	1414.20	2828.40	6.00	6.00	6.00
2-0 to 2-6 . . . . (6/1/81)	29.13	72.83	145.66	291.32	582.64	1456.60	2913.20	6.00	6.01	6.00
2-6 to 3-0 . . . . (12/1/81)	30.01	75.02	150.04	300.08	600.16	1500.40	3000.80	6.00	6.00	6.00
3-0 to 3-6 . . . . (6/1/82)	30.91	77.27	154.54	309.08	618.16	1545.40	3090.80	6.00	6.00	6.00
3-6 to 4-0 . . . . (12/1/82)	31.84	79.59	159.18	318.36	636.72	1591.80	3183.60	6.00	5.98	6.00
4-0 to 4-6 . . . . (6/1/83)	32.79	81.97	163.94	327.88	655.76	1639.40	3278.80	6.00	6.00	6.00
4-6 to 5-0 . . . . (12/1/83)	33.77	84.43	168.86	337.72	675.44	1688.60	3377.20	6.00	5.99	6.00
5-0 to 5-6 . . . . (6/1/84)	34.78	86.96	173.92	347.84	695.68	1739.20	3478.40	6.00	6.00	6.00
5-6 to 6-0 . . . . (12/1/84)	35.83	89.57	179.14	358.28	716.56	1791.40	3582.80	6.00	6.01	6.00
6-0 to 6-6 . . . . (6/1/85)	36.90	92.26	184.52	369.04	738.08	1845.20	3690.40	6.00	6.00	6.00
6-6 to 7-0 . . . . (12/1/85)	38.01	95.03	190.06	380.12	760.24	1900.60	3801.20	6.00	6.00	6.00
7-0 to 7-6 . . . . (6/1/86)	39.15	97.88	195.76	391.52	783.04	1957.60	3915.20	6.00	6.01	6.00
7-6 to 8-0 . . . . (12/1/86)	40.33	100.82	201.64	403.28	806.56	2016.40	4032.80	6.00	5.99	6.00
8-0 to 8-6 . . . . (6/1/87)	41.54	103.84	207.68	415.36	830.72	2076.80	4153.60	6.00	6.01	6.00
8-6 to 9-0 . . . . (12/1/87)	42.78	106.96	213.92	427.84	855.68	2139.20	4278.40	6.00	5.98	6.00
9-0 to 9-6 . . . . (6/1/88)	44.06	110.16	220.32	440.64	881.28	2203.20	4406.40	6.00	6.01	6.00
9-6 to 10-0 . . . . (12/1/88)	45.39	113.47	226.94	453.88	907.76	2269.40	4538.80	6.00	5.99	5.99
10-0 2/ . . . . . (6/1/89)	46.75	116.87	233.74	467.48	934.96	2337.40	4674.80	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1949, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.63 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 21-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1949, THROUGH MAY 1, 1950

Issue price	$7.50	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	Approximate investment yield (annual percentage rate)		
Denomination	10.00	25.00	50.00	100.00	200.00	500.00	1000.00			
Period (years and months after second extended maturity at 30 years 0 months)	(1) Redemption values during each half-year period (values increase on first day of period)* THIRD EXTENDED MATURITY PERIOD							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 3rd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/79)	$26.15	$65.38	$130.76	$261.52	$523.04	$1307.60	$2615.20	----	6.00	6.00
0-6 to 1-0 . . . . (6/1/80)	26.94	67.34	134.68	269.36	538.72	1346.80	2693.60	6.00	6.00	6.00
1-0 to 1-6 . . . . (12/1/80)	27.74	69.36	138.72	277.44	554.88	1387.20	2774.40	6.00	6.00	6.00
1-6 to 2-0 . . . . (6/1/81)	28.58	71.44	142.88	285.76	571.52	1428.80	2857.60	6.00	6.02	6.00
2-0 to 2-6 . . . . (12/1/81)	29.44	73.59	147.18	294.36	588.72	1471.80	2943.60	6.00	5.98	6.00
2-6 to 3-0 . . . . (6/1/82)	30.32	75.79	151.58	303.16	606.32	1515.80	3031.60	6.00	6.02	6.00
3-0 to 3-6 . . . . (12/1/82)	31.23	78.07	156.14	312.28	624.56	1561.40	3122.80	6.00	5.99	6.00
3-6 to 4-0 . . . . (6/1/83)	32.16	80.41	160.82	321.64	643.28	1608.20	3216.40	6.00	5.99	6.00
4-0 to 4-6 . . . . (12/1/83)	33.13	82.82	165.64	331.28	662.56	1656.40	3312.80	6.00	6.01	6.00
4-6 to 5-0 . . . . (6/1/84)	34.12	85.31	170.62	341.24	682.48	1706.20	3412.40	6.00	6.00	6.00
5-0 to 5-6 . . . . (12/1/84)	35.15	87.87	175.74	351.48	702.96	1757.40	3514.80	6.00	5.99	6.00
5-6 to 6-0 . . . . (6/1/85)	36.20	90.50	181.00	362.00	724.00	1810.00	3620.00	6.00	6.01	6.00
6-0 to 6-6 . . . . (12/1/85)	37.29	93.22	186.44	372.88	745.76	1864.40	3728.80	6.00	5.99	6.00
6-6 to 7-0 . . . . (6/1/86)	38.40	96.01	192.02	384.04	768.08	1920.20	3840.40	6.00	6.00	6.00
7-0 to 7-6 . . . . (12/1/86)	39.56	98.89	197.78	395.56	791.12	1977.80	3955.60	6.00	6.01	6.00
7-6 to 8-0 . . . . (6/1/87)	40.74	101.86	203.72	407.44	814.88	2037.20	4074.40	6.00	6.01	6.00
8-0 to 8-6 . . . . (12/1/87)	41.97	104.92	209.84	419.68	839.36	2098.40	4196.80	6.00	5.99	6.00
8-6 to 9-0 . . . . (6/1/88)	43.22	108.06	216.12	432.24	864.48	2161.20	4322.40	6.00	6.02	6.00
9-0 to 9-6 . . . . (12/1/88)	44.52	111.31	222.62	445.24	890.48	2226.20	4452.40	6.00	5.98	5.99
9-6 to 10-0 . . . . (6/1/89)	45.86	114.64	229.28	458.56	917.12	2292.80	4585.60	6.00	6.00	6.00
10-0 2/ . . . . . (12/1/89)	47.23	118.08	236.16	472.32	944.64	2361.60	4723.20	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1949, enter each period. For subsequent issue months add the appropriate number of months.
2/ Third extended maturity reached at 40 years 0 months after issue.
3/ Yield on purchase price from issue date to 3rd extended maturity date is 4.65 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 63-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH AUG. 1, 1961

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(3/1/79)	$44.17	$88.34	$176.68	$353.36	$883.40	$1766.80	$17668	----	6.02	6.00
0-6 to 1-0 . . . . (9/1/79)	45.50	91.00	182.00	364.00	910.00	1820.00	18200	6.02	5.98	6.00
1-0 to 1-6 . . . . (3/1/80)	46.86	93.72	187.44	374.88	937.20	1874.40	18744	6.00	6.02	6.00
1-6 to 2-0 . . . . (9/1/80)	48.27	96.54	193.08	386.16	965.40	1930.80	19308	6.01	5.97	6.00
2-0 to 2-6 . . . . (3/1/81)	49.71	99.42	198.84	397.68	994.20	1988.40	19884	6.00	6.04	6.00
2-6 to 3-0 . . . . (9/1/81)	51.21	102.42	204.84	409.68	1024.20	2048.40	20484	6.00	5.98	6.00
3-0 to 3-6 . . . . (3/1/82)	52.74	105.48	210.96	421.92	1054.80	2109.60	21096	6.00	5.99	6.00
3-6 to 4-0 . . . . (9/1/82)	54.32	108.64	217.28	434.56	1086.40	2172.80	21728	6.00	6.00	6.00
4-0 to 4-6 . . . . (3/1/83)	55.95	111.90	223.80	447.60	1119.00	2238.00	22380	6.00	6.01	6.00
4-6 to 5-0 . . . . (9/1/83)	57.63	115.26	230.52	461.04	1152.60	2305.20	23052	6.00	6.00	6.00
5-0 to 5-6 . . . . (3/1/84)	59.36	118.72	237.44	474.88	1187.20	2374.40	23744	6.00	6.00	6.00
5-6 to 6-0 . . . . (9/1/84)	61.14	122.28	244.56	489.12	1222.80	2445.60	24456	6.00	6.02	6.00
6-0 to 6-6 . . . . (3/1/85)	62.98	125.96	251.92	503.84	1259.60	2519.20	25192	6.00	6.00	6.00
6-6 to 7-0 . . . . (9/1/85)	64.87	129.74	259.48	518.96	1297.40	2594.80	25948	6.00	5.98	6.00
7-0 to 7-6 . . . . (3/1/86)	66.81	133.62	267.24	534.48	1336.20	2672.40	26724	6.00	6.02	6.00
7-6 to 8-0 . . . . (9/1/86)	68.82	137.64	275.28	550.56	1376.40	2752.80	27528	6.00	5.99	6.00
8-0 to 8-6 . . . . (3/1/87)	70.88	141.76	283.52	567.04	1417.60	2835.20	28352	6.00	6.01	6.00
8-6 to 9-0 . . . . (9/1/87)	73.01	146.02	292.04	584.08	1460.20	2920.40	29204	6.00	6.00	6.00
9-0 to 9-6 . . . . (3/1/88)	75.20	150.40	300.80	601.60	1504.00	3008.00	30080	6.00	5.98	6.00
9-6 to10-0 . . . . (9/1/88)	77.45	154.90	309.80	619.60	1549.00	3098.00	30980	6.00	6.02	6.02
10-0 2/ . . . . . (3/1/89)	79.78	159.56	319.12	638.24	1595.60	3191.20	31912	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1961, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.29 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 64-A

BONDS BEARING ISSUE DATES FROM SEPT. 1 THROUGH NOV. 1, 1961

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* — SECOND EXTENDED MATURITY PERIOD							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(6/1/79)	$44.56	$89.12	$178.24	$356.48	$891.20	$1782.40	$17824	—	6.01	6.00
0-6 to 1-0 . . . . (12/1/79)	45.90	91.80	183.60	367.20	918.00	1836.00	18360	6.01	5.97	6.00
1-0 to 1-6 . . . . (6/1/80)	47.27	94.54	189.08	378.16	945.40	1890.80	18908	5.99	6.01	6.00
1-6 to 2-0 . . . . (12/1/80)	48.69	97.38	194.76	389.52	973.80	1947.60	19476	6.00	6.00	6.00
2-0 to 2-6 . . . . (6/1/81)	50.15	100.30	200.60	401.20	1003.00	2006.00	20060	6.00	6.02	6.00
2-6 to 3-0 . . . . (12/1/81)	51.66	103.32	206.64	413.28	1033.20	2066.40	20664	6.00	6.00	6.00
3-0 to 3-6 . . . . (6/1/82)	53.21	106.42	212.84	425.68	1064.20	2128.40	21284	6.00	5.98	6.00
3-6 to 4-0 . . . . (12/1/82)	54.80	109.60	219.20	438.40	1096.00	2192.00	21920	6.00	6.02	6.00
4-0 to 4-6 . . . . (6/1/83)	56.45	112.90	225.80	451.60	1129.00	2258.00	22580	6.00	5.99	6.00
4-6 to 5-0 . . . . (12/1/83)	58.14	116.28	232.56	465.12	1162.80	2325.60	23256	6.00	5.99	6.00
5-0 to 5-6 . . . . (6/1/84)	59.88	119.76	239.52	479.04	1197.60	2395.20	23952	6.00	6.01	6.00
5-6 to 6-0 . . . . (12/1/84)	61.68	123.36	246.72	493.44	1233.60	2467.20	24672	6.00	6.00	6.00
6-0 to 6-6 . . . . (6/1/85)	63.53	127.06	254.12	508.24	1270.60	2541.20	25412	6.00	6.01	6.00
6-6 to 7-0 . . . . (12/1/85)	65.44	130.88	261.76	523.52	1308.80	2617.60	26176	6.00	5.99	6.00
7-0 to 7-6 . . . . (6/1/86)	67.40	134.80	269.60	539.20	1348.00	2696.00	26960	6.00	5.99	6.00
7-6 to 8-0 . . . . (12/1/86)	69.42	138.84	277.68	555.36	1388.40	2776.80	27768	6.00	6.02	6.00
8-0 to 8-6 . . . . (6/1/87)	71.51	143.02	286.04	572.08	1430.20	2860.40	28604	6.00	5.99	6.00
8-6 to 9-0 . . . . (12/1/87)	73.65	147.30	294.60	589.20	1473.00	2946.00	29460	6.00	6.00	6.00
9-0 to 9-6 . . . . (6/1/88)	75.86	151.72	303.44	606.88	1517.20	3034.40	30344	6.00	6.01	6.00
9-6 to 10-0 . . . . (12/1/88)	78.14	156.28	312.56	625.12	1562.80	3125.60	31256	6.00	5.99	5.99
10-0 2/ . . . . . (6/1/89)	80.48	160.96	321.92	643.84	1609.60	3219.20	32192	6.00 3/	—	—

1/ Month, day, and year on which issues of Sept. 1, 1961, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.32 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 65-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1961, THROUGH FEB. 1, 1962

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(9/1/79)	$44.69	$89.38	$178.76	$357.52	$893.80	$1787.60	$17876	----	6.00	6.00
0-6 to 1-0 . . . . (3/1/80)	46.03	92.06	184.12	368.24	920.60	1841.20	18412	6.00	6.00	6.00
1-0 to 1-6 . . . . (9/1/80)	47.41	94.82	189.64	379.28	948.20	1896.40	18964	6.00	5.99	6.00
1-6 to 2-0 . . . . (3/1/81)	48.83	97.66	195.32	390.64	976.60	1953.20	19532	5.99	6.02	6.00
2-0 to 2-6 . . . . (9/1/81)	50.30	100.60	201.20	402.40	1006.00	2012.00	20120	6.00	6.00	6.00
2-6 to 3-0 . . . . (3/1/82)	51.81	103.62	207.24	414.48	1036.20	2072.40	20724	6.00	5.98	6.00
3-0 to 3-6 . . . . (9/1/82)	53.36	106.72	213.44	426.88	1067.20	2134.40	21344	6.00	6.00	6.00
3-6 to 4-0 . . . . (3/1/83)	54.96	109.92	219.84	439.68	1099.20	2198.40	21984	6.00	6.00	6.00
4-0 to 4-6 . . . . (9/1/83)	56.61	113.22	226.44	452.88	1132.20	2264.40	22644	6.00	6.01	6.00
4-6 to 5-0 . . . . (3/1/84)	58.31	116.62	233.24	466.48	1166.20	2332.40	23324	6.00	6.00	6.00
5-0 to 5-6 . . . . (9/1/84)	60.06	120.12	240.24	480.48	1201.20	2402.40	24024	6.00	5.99	6.00
5-6 to 6-0 . . . . (3/1/85)	61.86	123.72	247.44	494.88	1237.20	2474.40	24744	6.00	6.01	6.00
6-0 to 6-6 . . . . (9/1/85)	63.72	127.44	254.88	509.76	1274.40	2548.80	25488	6.00	5.99	6.00
6-6 to 7-0 . . . . (3/1/86)	65.63	131.26	262.52	525.04	1312.60	2625.20	26252	6.00	6.00	6.00
7-0 to 7-6 . . . . (9/1/86)	67.60	135.20	270.40	540.80	1352.00	2704.00	27040	6.00	6.01	6.00
7-6 to 8-0 . . . . (3/1/87)	69.63	139.26	278.52	557.04	1392.60	2785.20	27852	6.00	5.97	6.00
8-0 to 8-6 . . . . (9/1/87)	71.71	143.42	286.84	573.68	1434.20	2868.40	28684	6.00	6.02	6.01
8-6 to 9-0 . . . . (3/1/88)	73.87	147.74	295.48	590.96	1477.40	2954.80	29548	6.00	5.98	6.00
9-0 to 9-6 . . . . (9/1/88)	76.08	152.16	304.32	608.64	1521.60	3043.20	30432	6.00	5.99	6.01
9-6 to 10-0 . . . . (3/1/89)	78.36	156.72	313.44	626.88	1567.20	3134.40	31344	6.00	6.02	6.02
10-0 2/ . . . . . (9/1/89)	80.72	161.44	322.88	645.76	1614.40	3228.80	32288	6.00 3/	----	----

1/ Month, day, and year on which issues of Dec. 1, 1961, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.33 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 66-A

BONDS BEARING ISSUE DATES FROM MARCH 1 THROUGH MAY 1, 1962

Issue price	$18.75	$37.50	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after first extended maturity at 17 years 9 months)	(1) Redemption values during each half-year period (values increase on first day of period)* SECOND EXTENDED MATURITY PERIOD							(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to 2nd extended maturity
								Percent	Percent	Percent
0-0 to 0-6 . . . 1/(12/1/79)	$44.90	$89.80	$179.60	$359.20	$898.00	$1796.00	$17960	----	6.01	6.00
0-6 to 1-0 . . . . (6/1/80)	46.25	92.50	185.00	370.00	925.00	1850.00	18500	6.01	5.97	6.00
1-0 to 1-6 . . . . (12/1/80)	47.63	95.26	190.52	381.04	952.60	1905.20	19052	5.99	6.00	6.00
1-6 to 2-0 . . . . (6/1/81)	49.06	98.12	196.24	392.48	981.20	1962.40	19624	6.00	6.03	6.00
2-0 to 2-6 . . . . (12/1/81)	50.54	101.08	202.16	404.32	1010.80	2021.60	20216	6.00	5.98	6.00
2-6 to 3-0 . . . . (6/1/82)	52.05	104.10	208.20	416.40	1041.00	2082.00	20820	6.00	5.99	6.00
3-0 to 3-6 . . . . (12/1/82)	53.61	107.22	214.44	428.88	1072.20	2144.40	21444	6.00	6.01	6.00
3-6 to 4-0 . . . . (6/1/83)	55.22	110.44	220.88	441.76	1104.40	2208.80	22088	6.00	6.01	6.00
4-0 to 4-6 . . . . (12/1/83)	56.88	113.76	227.52	455.04	1137.60	2275.20	22752	6.00	5.98	6.00
4-6 to 5-0 . . . . (6/1/84)	58.58	117.16	234.32	468.64	1171.60	2343.20	23432	6.00	6.01	6.00
5-0 to 5-6 . . . . (12/1/84)	60.34	120.68	241.36	482.72	1206.80	2413.60	24136	6.00	6.00	6.00
5-6 to 6-0 . . . . (6/1/85)	62.15	124.30	248.60	497.20	1243.00	2486.00	24860	6.00	6.02	6.00
6-0 to 6-6 . . . . (12/1/85)	64.02	128.04	256.08	512.16	1280.40	2560.80	25608	6.00	6.00	6.00
6-6 to 7-0 . . . . (6/1/86)	65.94	131.88	263.76	527.52	1318.80	2637.60	26376	6.00	6.01	6.00
7-0 to 7-6 . . . . (12/1/86)	67.92	135.84	271.68	543.36	1358.40	2716.80	27168	6.00	5.98	6.00
7-6 to 8-0 . . . . (6/1/87)	69.95	139.90	279.80	559.60	1399.00	2798.00	27980	6.00	6.00	6.00
8-0 to 8-6 . . . . (12/1/87)	72.05	144.10	288.20	576.40	1441.00	2882.00	28820	6.00	6.00	6.00
8-6 to 9-0 . . . . (6/1/88)	74.21	148.42	296.84	593.68	1484.20	2968.40	29684	6.00	6.01	6.00
9-0 to 9-6 . . . . (12/1/88)	76.44	152.88	305.76	611.52	1528.80	3057.60	30576	6.00	5.99	5.99
9-6 to10-0 . . . . (6/1/89)	78.73	157.46	314.92	629.84	1574.60	3149.20	31492	6.00	6.00	6.00
10-0 2/ . . . . . (12/1/89)	81.09	162.18	324.36	648.72	1621.80	3243.60	32436	6.00 3/	----	----

1/ Month, day, and year on which issues of March 1, 1962, enter each period. For subsequent issue months add the appropriate number of months.
2/ Second extended maturity reached at 27 years 9 months after issue.
3/ Yield on purchase price from issue date to 2nd extended maturity date is 5.35 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 96-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1973

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 5 years 10 months)	(1) Redemption values during each half-year period (values increase on first day of period)* EXTENDED MATURITY PERIOD								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(4/1/79)	$26.40	$52.80	$79.20	$105.60	$211.20	$528.00	$1056.00	$10560	----	5.98	6.00
0-6 to 1-0 . . . . (10/1/79)	27.19	54.38	81.57	108.76	217.52	543.80	1087.60	10876	5.98	6.03	6.00
1-0 to 1-6 . . . . (4/1/80)	28.01	56.02	84.03	112.04	224.08	560.20	1120.40	11204	6.01	6.00	6.00
1-6 to 2-0 . . . . (10/1/80)	28.85	57.70	86.55	115.40	230.80	577.00	1154.00	11540	6.00	5.96	6.00
2-0 to 2-6 . . . . (4/1/81)	29.71	59.42	89.13	118.84	237.68	594.20	1188.40	11884	5.99	5.99	6.00
2-6 to 3-0 . . . . (10/1/81)	30.60	61.20	91.80	122.40	244.80	612.00	1224.00	12240	5.99	6.01	6.00
3-0 to 3-6 . . . . (4/1/82)	31.52	63.04	94.56	126.08	252.16	630.40	1260.80	12608	6.00	6.03	6.00
3-6 to 4-0 . . . . (10/1/82)	32.47	64.94	97.41	129.88	259.76	649.40	1298.80	12988	6.00	5.97	6.00
4-0 to 4-6 . . . . (4/1/83)	33.44	66.88	100.32	133.76	267.52	668.80	1337.60	13376	6.00	6.04	6.00
4-6 to 5-0 . . . . (10/1/83)	34.45	68.90	103.35	137.80	275.60	689.00	1378.00	13780	6.00	5.98	6.00
5-0 to 5-6 . . . . (4/1/84)	35.48	70.96	106.44	141.92	283.84	709.60	1419.20	14192	6.00	5.98	6.00
5-6 to 6-0 . . . . (10/1/84)	36.54	73.08	109.62	146.16	292.32	730.80	1461.60	14616	6.00	6.02	6.00
6-0 to 6-6 . . . . (4/1/85)	37.64	75.28	112.92	150.56	301.12	752.80	1505.60	15056	6.00	6.00	6.00
6-6 to 7-0 . . . . (10/1/85)	38.77	77.54	116.31	155.08	310.16	775.40	1550.80	15508	6.00	5.98	6.00
7-0 to 7-6 . . . . (4/1/86)	39.93	79.86	119.79	159.72	319.44	798.60	1597.20	15972	6.00	6.01	6.00
7-6 to 8-0 . . . . (10/1/86)	41.13	82.26	123.39	164.52	329.04	822.60	1645.20	16452	6.00	5.98	6.00
8-0 to 8-6 . . . . (4/1/87)	42.36	84.72	127.08	169.44	338.88	847.20	1694.40	16944	6.00	6.04	6.00
8-6 to 9-0 . . . . (10/1/87)	43.64	87.28	130.92	174.56	349.12	872.80	1745.60	17456	6.00	5.96	5.99
9-0 to 9-6 . . . . (4/1/88)	44.94	89.88	134.82	179.76	359.52	898.80	1797.60	17976	6.00	6.01	6.01
9-6 to10-0 . . . . (10/1/88)	46.29	92.58	138.87	185.16	370.32	925.80	1851.60	18516	6.00	6.01	6.01
10-0 2/ . . . . . (4/1/89)	47.68	95.36	143.04	190.72	381.44	953.60	1907.20	19072	6.00 3/	----	----

1/ Month, day, and year on which issues of June 1, 1973, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 10 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 5.98 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 98

BONDS BEARING ISSUE DATES FROM JAN. 1, 1974, THROUGH DEC. 1, 1974

Issue price		$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$ 7500	Approximate investment yield (annual percentage rate)		
Denomination		25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after issue)		(1) Redemption values during each half-year period (values increase on first day of period)								(2) From issue date to beginning of each ½-yr. period	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to maturity
										Percent	Percent	Percent
0-0 to 0-6 . . . 1/	(1/1/74)	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$ 7500	—	3.73	6.00
0-6 to 1-0	(7/1/74)	19.10	38.20	57.30	76.40	152.80	382.00	764.00	7640	3.73	5.34	6.25
1-0 to 1-6	(1/1/75)	19.61	39.22	58.83	78.44	156.88	392.20	784.40	7844	4.54	5.00	6.37
1-6 to 2-0	(7/1/75)	20.10	40.20	60.30	80.40	160.80	402.00	804.00	8040	4.69	4.98	6.57
2-0 to 2-6	(1/1/76)	20.60	41.20	61.80	82.40	164.80	412.00	824.00	8240	4.76	5.24	6.83
2-6 to 3-0	(7/1/76)	21.14	42.28	63.42	84.56	169.12	422.80	845.60	8456	4.86	5.39	7.15
3-0 to 3-6	(1/1/77)	21.71	43.42	65.13	86.84	173.68	434.20	868.40	8684	4.95	5.53	7.59
3-6 to 4-0	(7/1/77)	22.31	44.62	66.93	89.24	178.48	446.20	892.40	8924	5.03	5.92	8.29
4-0 to 4-6	(1/1/78)	22.97	45.94	68.91	91.80	183.76	459.40	918.80	9188	5.14	6.09	9.48
4-6 to 5-0	(7/1/78)	23.67	47.34	71.01	94.68	189.36	473.40	946.80	9468	5.25	12.93	12.93
5-0 2/	(1/1/79)	25.20	50.40	75.60	100.80	201.60	504.00	1008.00	10080	6.00	—	—

1/ Month, day and year on which issues of January 1, 1974, enter each period. For subsequent issue months add the appropriate number of months.
2/ Maturity value reached at 5 years and 0 months after issue.

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TABLE 98-A

BONDS BEARING ISSUE DATES FROM JAN. 1, 1974, THROUGH DEC. 1, 1974

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after original maturity at 5 years 0 months)**	(1) Redemption values during each half-year period (values increase on first day of period)* — EXTENDED MATURITY PERIOD								(2) From beginning of current maturity period to beginning of each ½-yr. pd.	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to extended maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/(1/1/79)	$25.20	$50.40	$75.60	$100.80	$201.60	$504.00	$1008.00	$10080	----	6.03	6.00
0-6 to 1-0 . . . . (7/1/79)	25.96	51.92	77.88	103.84	207.68	519.20	1038.40	10384	6.03	5.93	6.00
1-0 to 1-6 . . . . (1/1/80)	26.73	53.46	80.19	106.92	213.84	534.60	1069.20	10692	5.98	6.06	6.00
1-6 to 2-0 . . . . (7/1/80)	27.54	55.08	82.62	110.16	220.32	550.80	1101.60	11016	6.01	5.95	6.00
2-0 to 2-6 . . . . (1/1/81)	28.36	56.72	85.08	113.44	226.88	567.20	1134.40	11344	5.99	5.99	6.00
2-6 to 3-0 . . . . (7/1/81)	29.21	58.42	87.63	116.84	233.68	584.20	1168.40	11684	5.99	6.03	6.00
3-0 to 3-6 . . . . (1/1/82)	30.09	60.18	90.27	120.36	240.72	601.80	1203.60	12036	6.00	5.98	6.00
3-6 to 4-0 . . . . (7/1/82)	30.99	61.98	92.97	123.96	247.92	619.80	1239.60	12396	6.00	6.00	6.00
4-0 to 4-6 . . . . (1/1/83)	31.92	63.84	95.76	127.68	255.36	638.40	1276.80	12768	6.00	6.02	6.00
4-6 to 5-0 . . . . (7/1/83)	32.88	65.76	98.64	131.52	263.04	657.60	1315.20	13152	6.00	6.02	6.00
5-0 to 5-6 . . . . (1/1/84)	33.87	67.74	101.61	135.48	270.96	677.40	1354.80	13548	6.00	5.96	6.00
5-6 to 6-0 . . . . (7/1/84)	34.88	69.76	104.64	139.52	279.04	697.60	1395.20	13952	6.00	6.02	6.00
6-0 to 6-6 . . . . (1/1/85)	35.93	71.86	107.79	143.72	287.44	718.60	1437.20	14372	6.00	6.01	6.00
6-6 to 7-0 . . . . (7/1/85)	37.01	74.02	111.03	148.04	296.08	740.20	1480.40	14804	6.00	6.00	6.00
7-0 to 7-6 . . . . (1/1/86)	38.12	76.24	114.36	152.48	304.96	762.40	1524.80	15248	6.00	5.98	5.99
7-6 to 8-0 . . . . (7/1/86)	39.26	78.52	117.78	157.04	314.08	785.20	1570.40	15704	6.00	6.01	6.00
8-0 to 8-6 . . . . (1/1/87)	40.44	80.88	121.32	161.76	323.52	808.80	1617.60	16176	6.00	5.98	5.99
8-6 to 9-0 . . . . (7/1/87)	41.65	83.30	124.95	166.60	333.20	833.00	1666.00	16660	6.00	6.00	6.00
9-0 to 9-6 . . . . (1/1/88)	42.90	85.80	128.70	171.60	343.20	858.00	1716.00	17160	6.00	6.01	5.99
9-6 to 10-0 . . . . (7/1/88)	44.19	88.38	132.57	176.76	353.52	883.80	1767.60	17676	6.00	5.97	5.97
10-0 2/ . . . . . . (1/1/89)	45.51	91.02	136.53	182.04	364.08	910.20	1820.40	18204	6.00 3/	----	----

1/ Month, day, and year on which issues of Jan. 1, 1974, enter each period. For subsequent issue months add the appropriate number of months.
2/ Extended maturity reached at 15 years 0 months after issue.
3/ Yield on purchase price from issue date to extended maturity date is 6.00 percent.

* For earlier redemption values and yields see appropriate table in Department Circular 653, 9th Revision, as amended and supplemented.
** This table does not apply if the prevailing rate for Series E bonds being issued at the time the extension begins is different from 6.00 percent.

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TABLE 99

BONDS BEARING ISSUE DATES FROM JAN. 1, 1975, THROUGH AUG. 1, 1976

Issue price	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$ 7500	Approximate investment yield (annual percentage rate)		
Denomination	25.00	50.00	75.00	100.00	200.00	500.00	1000.00	10000			
Period (years and months after issue)	(1) Redemption values during each half-year period (values increase on first day of period)								(2) From issue date to beginning of each ½-yr. period	(3) From beginning of each ½-yr. period to beginning of next ½-yr. pd.	(4) From beginning of each ½-yr. period to maturity
									Percent	Percent	Percent
0-0 to 0-6 . . . 1/ (1/1/75)	$18.75	$37.50	$56.25	$75.00	$150.00	$375.00	$750.00	$ 7500	—	3.73	6.00
0-6 to 1-0 . . . . (7/1/75)	19.10	38.20	57.30	76.40	152.80	382.00	764.00	7640	3.73	5.34	6.25
1-0 to 1-6 . . . . (1/1/76)	19.61	39.22	58.83	78.44	156.88	392.20	784.40	7844	4.54	5.00	6.37
1-6 to 2-0 . . . . (7/1/76)	20.10	40.20	60.30	80.40	160.80	402.00	804.00	8040	4.69	4.98	6.57
2-0 to 2-6 . . . . (1/1/77)	20.60	41.20	61.80	82.40	164.80	412.00	824.00	8240	4.76	5.24	6.83
2-6 to 3-0 . . . . (7/1/77)	21.14	42.28	63.42	84.56	169.12	422.80	845.60	8456	4.86	5.39	7.15
3-0 to 3-6 . . . . (1/1/78)	21.71	43.42	65.13	86.84	173.68	434.20	868.40	8684	4.95	5.53	7.59
3-6 to 4-0 . . . . (7/1/78)	22.31	44.62	66.93	89.24	178.48	446.20	892.40	8924	5.03	5.92	8.29
4-0 to 4-6 . . . . (1/1/79)	22.97	45.94	68.91	91.88	183.76	459.40	918.80	9188	5.14	6.09	9.48
4-6 to 5-0 . . . . (7/1/79)	23.67	47.34	71.01	94.68	189.36	473.40	946.80	9468	5.25	12.93	12.93
5-0 2/ . . . . . (1/1/80)	25.20	50.40	75.60	100.80	201.60	504.00	1008.00	10080	6.00	—	—

1/ Month, day and year on which issues of January 1, 1975, enter each period. For subsequent issue months add the appropriate number of months.
2/ Maturity value reached at 5 years and 0 months after issue.

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Exhibit 5.—Department Circular No. 905, Sixth Revision, April 19, 1974, amended, offering of United States savings bonds, Series H

DEPARTMENT OF THE TREASURY,
Washington, December 21, 1978.

SUMMARY: The purpose of this amendment to the current offering circular for United States savings bonds, Series H, is to grant a second extended maturity period to certain bonds and to show the schedule of interest payments and investment yields for bonds of various issue dates during their first or next extended maturity period.

EFFECTIVE DATE: January 16, 1979.

SUPPLEMENTARY INFORMATION: Series H savings bonds have a 10-year original maturity period and, unless sooner redeemed, have an automatic 10-year extended maturity period. Subsequent extensions are customarily granted to them at the time they approach the end of their extended maturity period. During 1979, Series H bonds bearing issue dates of June 1, 1959, through December 1, 1959, will reach the end of their first extended maturity period. This amendment grants a second 10-year extended maturity period to these bonds.

Additionally, the tables contained in the offering circular for Series H savings bonds show the schedule of interest payments and investment yields for bonds of all issue dates. Each table covers particular groupings of issue dates. When the earlier dated bonds in any group reach the end of an original or extended maturity period, it is necessary to publish a new table to reflect the interest payments and investment yields that will apply to their first or next extended maturity period. During 1979, the earlier dated bonds in each of the following groups will enter their first or next extended maturity period:

(1) Table 17—bonds dated June 1 through November 1, 1959;
(2) Table 18—bonds dated December 1, 1959, through May 1, 1960;
(3) Table 37—bonds dated June 1 through November 1, 1969;
(4) Table 38—bonds dated December 1, 1969, through May 1, 1970.

It should be noted that, in some cases, later dated bonds in the above groups will not enter their first or next extended maturity period until after 1979. As extensions have already been irrevocably granted to these bonds, the supplemental tables published below will apply to them, provided there is no intervening change in the interest rate paid on saving bonds.

Accordingly, Section 332.8(a)(2) and (3) of Department of the Treasury Circular No. 905, Sixth Revision, as amended, (31 CFR 332), is hereby further amended, and Tables 17-A, 18-A, 37-A and 38-A are added, as follows:

§332.8 Extended terms and improved yields for outstanding bonds.

(a) *Extended maturity periods* * * *

(2) Bonds with issue dates June 1, 1952, through May 1, 1960. Owners of Series H bonds with issue dates of June 1, 1952, through May 1, 1960, may retain their bonds for a second extended maturity period of 10 years.

(3) *Bonds with issue dates of June 1, 1960, or thereafter.* Owners of Series H bonds with issue dates of June 1, 1960, or thereafter, may retain their bonds for an extended maturity period of 10 years.

* * * * * * *

The foregoing amendment was effected under authority of Section 22 of the Second Liberty Bond Act, as amended (49 Stat. 21, as amended; 31 U.S.C. 757c), and 5 U.S.C. 301.

Since this amendment involves the fiscal policy of the United States and does not meet the Department's criteria for significant regulations, it has been determined that notice and public procedures thereon are unnecessary.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

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TABLE 17-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1959

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 20 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (12/1/79)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (6/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (12/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (6/1/87)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (12/1/87)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (6/1/88)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (12/1/88)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (6/1/89)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF JUNE 1, 1959. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.
2/ SECOND EXTENDED MATURITY REACHED AT 30 YEARS AND 0 MONTHS AFTER ISSUE DATE.
3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY IS 4.84%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.
** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

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TABLE 18-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1959 THROUGH MAY 1, 1960

ISSUE PRICE	$500	$1,000	$5,000	$10,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000	10,000			
PERIOD OF TIME BOND IS HELD AFTER EXTENDED MATURITY AT 20 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * SECOND EXTENDED MATURITY PERIOD**				(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRECEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO 2ND EXTENDED MATURITY
					PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (6/1/80)	$15.00	$30.00	$150.00	$300.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/85)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/86)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/87)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/87)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/88)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/88)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/89)	15.00	30.00	150.00	300.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/89)	15.00	30.00	150.00	300.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF DEC. 1, 1959. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.
2/ SECOND EXTENDED MATURITY REACHED AT 30 YEARS AND 0 MONTHS AFTER ISSUE DATE.
3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO SECOND EXTENDED MATURITY IS 4.86%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.
** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

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TABLE 37-A

BONDS BEARING ISSUE DATES FROM JUNE 1 THROUGH NOV. 1, 1969

ISSUE PRICE	$500	$1,000	$5,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000			
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION * — EXTENDED MATURITY PERIOD**			(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
				PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (12/1/79)	$15.00	$30.00	$150.00	6.00	6.00	6.00
1.0 YEARS . . . . (6/1/80)	15.00	30.00	150.00	6.00	6.00	6.00
1.5 YEARS . . . . (12/1/80)	15.00	30.00	150.00	6.00	6.00	6.00
2.0 YEARS . . . . (6/1/81)	15.00	30.00	150.00	6.00	6.00	6.00
2.5 YEARS . . . . (12/1/81)	15.00	30.00	150.00	6.00	6.00	6.00
3.0 YEARS . . . . (6/1/82)	15.00	30.00	150.00	6.00	6.00	6.00
3.5 YEARS . . . . (12/1/82)	15.00	30.00	150.00	6.00	6.00	6.00
4.0 YEARS . . . . (6/1/83)	15.00	30.00	150.00	6.00	6.00	6.00
4.5 YEARS . . . . (12/1/83)	15.00	30.00	150.00	6.00	6.00	6.00
5.0 YEARS . . . . (6/1/84)	15.00	30.00	150.00	6.00	6.00	6.00
5.5 YEARS . . . . (12/1/84)	15.00	30.00	150.00	6.00	6.00	6.00
6.0 YEARS . . . . (6/1/85)	15.00	30.00	150.00	6.00	6.00	6.00
6.5 YEARS . . . . (12/1/85)	15.00	30.00	150.00	6.00	6.00	6.00
7.0 YEARS . . . . (6/1/86)	15.00	30.00	150.00	6.00	6.00	6.00
7.5 YEARS . . . . (12/1/86)	15.00	30.00	150.00	6.00	6.00	6.00
8.0 YEARS . . . . (6/1/87)	15.00	30.00	150.00	6.00	6.00	6.00
8.5 YEARS . . . . (12/1/87)	15.00	30.00	150.00	6.00	6.00	6.00
9.0 YEARS . . . . (6/1/88)	15.00	30.00	150.00	6.00	6.00	6.00
9.5 YEARS . . . . (12/1/88)	15.00	30.00	150.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (6/1/89)	15.00	30.00	150.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF JUNE 1, 1969. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.
2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.
3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.79%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

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TABLE 38-A

BONDS BEARING ISSUE DATES FROM DEC. 1, 1969 THROUGH MAY 1, 1970

ISSUE PRICE	$500	$1,000	$5,000	APPROXIMATE INVESTMENT YIELD (ANNUAL PERCENTAGE RATE)		
REDEMPTION AND MATURITY VALUE	500	1,000	5,000			
PERIOD OF TIME BOND IS HELD AFTER FIRST MATURITY AT 10 YEARS, 0 MONTHS	(1) AMOUNTS OF INTEREST CHECKS FOR EACH DENOMINATION *			(2) FROM BEGINNING OF CURRENT MATURITY PD. TO EA. INTEREST PMT. DATE	(3) FOR HALF-YEAR PD. PRE-CEDING INTEREST PAYMENT DATE	(4) FROM EACH INTEREST PMT. DATE TO FIRST EXTENDED MATURITY
	EXTENDED MATURITY PERIOD**					
				PERCENT	PERCENT	PERCENT
.5 YEARS . . .1/ (6/1/80)	$15.00	$30.00	$150.00	6.00	6.00	6.00
1.0 YEARS . . . . (12/1/80)	15.00	30.00	150.00	6.00	6.00	6.00
1.5 YEARS . . . . (6/1/81)	15.00	30.00	150.00	6.00	6.00	6.00
2.0 YEARS . . . . (12/1/81)	15.00	30.00	150.00	6.00	6.00	6.00
2.5 YEARS . . . . (6/1/82)	15.00	30.00	150.00	6.00	6.00	6.00
3.0 YEARS . . . . (12/1/82)	15.00	30.00	150.00	6.00	6.00	6.00
3.5 YEARS . . . . (6/1/83)	15.00	30.00	150.00	6.00	6.00	6.00
4.0 YEARS . . . . (12/1/83)	15.00	30.00	150.00	6.00	6.00	6.00
4.5 YEARS . . . . (6/1/84)	15.00	30.00	150.00	6.00	6.00	6.00
5.0 YEARS . . . . (12/1/84)	15.00	30.00	150.00	6.00	6.00	6.00
5.5 YEARS . . . . (6/1/85)	15.00	30.00	150.00	6.00	6.00	6.00
6.0 YEARS . . . . (12/1/85)	15.00	30.00	150.00	6.00	6.00	6.00
6.5 YEARS . . . . (6/1/86)	15.00	30.00	150.00	6.00	6.00	6.00
7.0 YEARS . . . . (12/1/86)	15.00	30.00	150.00	6.00	6.00	6.00
7.5 YEARS . . . . (6/1/87)	15.00	30.00	150.00	6.00	6.00	6.00
8.0 YEARS . . . . (12/1/87)	15.00	30.00	150.00	6.00	6.00	6.00
8.5 YEARS . . . . (6/1/88)	15.00	30.00	150.00	6.00	6.00	6.00
9.0 YEARS . . . . (12/1/88)	15.00	30.00	150.00	6.00	6.00	6.00
9.5 YEARS . . . . (6/1/89)	15.00	30.00	150.00	6.00	6.00	6.00
10.0 YEARS 2/. . . (12/1/89)	15.00	30.00	150.00	3/ 6.00	6.00	----

1/ MONTH, DAY AND YEAR ON WHICH INTEREST CHECK IS PAYABLE ON ISSUES OF DEC. 1, 1969. FOR SUBSEQUENT ISSUE MONTHS ADD APPROPRIATE NUMBER OF MONTHS.

2/ EXTENDED MATURITY REACHED AT 20 YEARS AND 0 MONTHS AFTER ISSUE DATE.

3/ YIELD ON PURCHASE PRICE FROM ISSUE DATE TO EXTENDED MATURITY IS 5.83%.

* FOR EARLIER INTEREST CHECKS AND YIELDS SEE APPROPRIATE TABLE IN DEPARTMENT CIRCULAR 905, 6TH REVISION, AS AMENDED AND SUPPLEMENTED.

** THIS TABLE DOES NOT APPLY IF THE PREVAILING RATE FOR SERIES H BONDS BEING ISSUED AT THE TIME THE EXTENSION BEGINS IS DIFFERENT FROM 6.00 PERCENT.

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Exhibit 6.—Department Circular No. 300, Fourth Revision, March 9, 1973, amended, general regulations governing United States securities

DEPARTMENT OF THE TREASURY,
Washington, June 5, 1979.

SUMMARY: The purpose of this amendment of the General Regulations governing United States securities is to extend the tables contained in the appendix to Subpart E to provide decimal factors for daily interest computations for interest payable on a semiannual or annual basis for interest rates of up to 12 percent per annum.

EFFECTIVE DATE: June 14, 1979.

SUPPLEMENTARY INFORMATION: Tables I and II in the appendix to Subpart E of the regulations provide decimal factors which are used to compute daily accrued interest on a security, based on the annual interest rate paid thereon. Both Table I, which provides the decimal factors for interest payable on a semiannual basis, and Table II, which provides the decimal factors for interest payable on an annual basis, now only cover interest rates extending to 6 percent per annum. In view of current interest rates being paid on United States securities, these tables are being extended to cover interest rates of up to 12 percent per annum.

Accordingly, Department of the Treasury Circular No. 300, Fourth Revision, dated March 9, 1973 (31 CFR, Part 306), is hereby amended by the deletion of Tables I and II in the Appendix to Subpart E and the addition of new Tables I and II.

The foregoing amendment was effected under authority of the Second Liberty Bond Act (40 Stat. 288, as amended; 31 U.S.C. 752, et seq.) and 5 U.S.C. 321. Since this amendment involves the fiscal policy of the United States and does not meet the Department's criteria for significant regulations, it has been determined that notice and public procedures thereon are unnecessary.

PAUL H. TAYLOR,
Fiscal Assistant Secretary.

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Table I.—*Decimal for 1 day's interest on $1,000 at various rates of interest, payable semiannually or on a semiannual basis in regular years of 365 days and in leap years of 366 days (to determine applicable number of days, see "computation of interest on semiannual basis")*

Rate per annum (percent)	Half-year of 184 days	Half-year of 183 days	Half year of 182 days	Half year of 181 days
1/8	$0.003396739	$0.003415301	$0.003434066	$0.003453039
1/4	.006793478	.006830601	.006868132	.006906077
3/8	.010190217	.010245902	.010302198	.010359116
1/2	.013586957	.013661202	.013736264	.013812155
5/8	.016983696	.017076503	.017170330	.017265193
3/4	.020380435	.020491803	.020604396	.020718232
7/8	.023777174	.023907104	.024038462	.024171271
1	.027173913	.027322404	.027472527	.027624309
1 1/8	.030570652	.030737705	.030906593	.031077348
1 1/4	.033967391	.034153005	.034340659	.034530387
1 3/8	.037364130	.037568306	.037774725	.037983425
1 1/2	.040760870	.040983607	.041208791	.041436464
1 5/8	.044157609	.044398907	.044642857	.044889503
1 3/4	.047554348	.047814208	.048076923	.048342541
1 7/8	.050951087	.051229508	.051510989	.051795580
2	.054347826	.054644809	.054945055	.055248619
2 1/8	.057744565	.058060109	.058379121	.058701657
2 1/4	.061141304	.061475410	.061813187	.062154696
2 3/8	.064538403	.064890710	.065247253	.065607735
2 1/2	.067934783	.068306011	.068681319	.069060773
2 5/8	.071331522	.071721311	.072115385	.072513812
2 3/4	.074728261	.075136612	.075549451	.075966851
2 7/8	.078125000	.078551913	.078983516	.079419890
3	.081521739	.081967213	.082417582	.082872928
3 1/8	.084918478	.085382514	.085851648	.086325967
3 1/4	.088315217	.088797814	.089285714	.089779006
3 3/8	.091711957	.092213115	.092719780	.093232044
3 1/2	.095108696	.095628415	.096153846	.096685083
3 5/8	.098505435	.099043716	.099587912	.100138122
3 3/4	.101902174	.102459016	.103021978	.103591160
3 7/8	.105298913	.105874317	.106456044	.107044199
4	.108695652	.109289617	.109890110	.110497238
4 1/8	.112092391	.112704918	.113324176	.113950276
4 1/4	.115489130	.116120219	.116758242	.117403315
4 3/8	.118885870	.119535519	.120192308	.120856354
4 1/2	.122282609	.122950820	.123626374	.124309392
4 5/8	.125679348	.126366120	.127060440	.127762431
4 3/4	.129076087	.129781421	.130494505	.131215470
4 7/8	.132472826	.133196721	.133928571	.134668508
5	.135869565	.136612022	.137362637	.138121547
5 1/8	.139266304	.140027322	.140796703	.141574586
5 1/4	.142663043	.143442623	.144230769	.145027624
5 3/8	.146059783	.146857923	.147664835	.148480663
5 1/2	.149456522	.150273224	.151098901	.151933702
5 5/8	.152853261	.153688525	.154532967	.155386740
5 3/4	.156250000	.157103825	.157967033	.158839779
5 7/8	.159646739	.160519126	.161401099	.162292818
6	.163043478	.163934426	.164835165	.165745856
6 1/8	.166440217	.167349727	.168269231	.169198895
6 1/4	.169836957	.170765027	.171703297	.172651934
6 3/8	.173233696	.174180328	.175137863	.176104972
6 1/2	.176630435	.177595628	.178571429	.179558011
6 5/8	.180027174	.181010929	.182005495	.183011050
6 3/4	.183423913	.184426230	.185439560	.186464088
6 7/8	.186820652	.187841530	.188873626	.189917127

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Table I.—*Decimal for 1 day's interest on $1,000 at various rates of interest, payable semiannually or on a semiannual basis in regular years of 365 days and in leap years of 366 days (to determine applicable number of days, see "computation of interest on semiannual basis")*—Continued

Rate per annum (percent)	Half-year of 184 days	Half-year of 183 days	Half-year of 182 days	Half-year of 181 days
7	$0.190217391	$0.191256831	$0.192307692	$0.193370166
7⅛	.193614130	.194672131	.195741758	.196823204
7¼	.197010870	.198087432	.199175824	.200276243
7⅜	.200407609	.201502732	.202609890	.203729282
7½	.203804348	.204918033	.206043956	.207182320
7⅝	.207201087	.208333333	.209478022	.210635359
7¾	.210597826	.211748634	.212912088	.214088398
7⅞	.213994565	.215163934	.216346154	.217541436
8	.217391304	.218579235	.219780220	.220994475
8⅛	.220788043	.221994536	.223214286	.224447514
8¼	.224184783	.225409836	.226648352	.227900552
8⅜	.227581522	.228825137	.230082418	.231353591
8½	.230978261	.232240437	.233516484	.234806630
8⅝	.234375000	.235655738	.236950549	.238259669
8¾	.237771739	.239071038	.240384615	.241712707
8⅞	.241168478	.242486339	.243818681	.245165746
9	.244565217	.245901639	.247252747	.248618785
9⅛	.247961957	.249316940	.250686813	.252071823
9¼	.251358696	.252732240	.254120879	.255524862
9⅜	.254755435	.256147541	.257554945	.258977901
9½	.258152174	.259562842	.260989011	.262430939
9⅝	.261548913	.262978142	.264423077	.265883978
9¾	.264945652	.266393443	.267857143	.269337017
9⅞	.268342391	.269808743	.271291209	.272790055
10	.271739130	.273224044	.274725275	.276243094
10⅛	.275135870	.276639344	.278159341	.279696133
10¼	.278532609	.280054645	.281593407	.283149171
10⅜	.281929348	.283469945	.285027473	.286602210
10½	.285326087	.286885246	.288461538	.290055249
10⅝	.288722826	.290300546	.291895604	.293508287
10¾	.292119565	.293715847	.295329670	.296961326
10⅞	.295516304	.297131148	.298763736	.300414365
11	.298913043	.300546448	.302197802	.303867403
11⅛	.302309783	.303961749	.305631868	.307320442
11¼	.305706522	.307377049	.309065934	.310773481
11⅜	.309103261	.310792350	.312500000	.314226519
11½	.312500000	.314207650	.315934066	.317679558
11⅝	.315896739	.317622951	.319368132	.321132597
11¾	.319293478	.321038251	.322802198	.324585635
11⅞	.322690217	.324453552	.326236264	.328038674
12	.326086957	.327868852	.329670330	.331491713

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TABLE II.—*Decimal for 1 day's interest on $1,000 at various rates of interest, payable annually or on an annual basis, in regular years of 365 days and in leap years of 366 days.*

Rate per annum (percent)	Regular year 365 days	Leap year 366 days
1/8	$0.003424658	$0.003415301
1/4	.006849315	.006830601
3/8	.010273973	.010245902
1/2	.013698630	.013661202
5/8	.017123288	.017076503
3/4	.020547945	.020491803
7/8	.023972603	.023907104
1	.027397260	.027322404
1 1/8	.030821918	.030737705
1 1/4	.034246575	.034153005
1 3/8	.037671233	.037568306
1 1/2	.041095890	.040983607
1 5/8	.044520548	.044398907
1 3/4	.047945205	.047814208
1 7/8	.051369863	.051229508
2	.054794521	.054644809
2 1/8	.058219178	.058060109
2 1/4	.061643836	.061475410
2 3/8	.065068493	.064890710
2 1/2	.068493151	.068306011
2 5/8	.071917808	.071721311
2 3/4	.075342466	.075136612
2 7/8	.078767123	.078551913
3	.082191781	.081967213
3 1/8	.085616438	.085382514
3 1/4	.089041096	.088797814
3 3/8	.092465753	.092213115
3 1/2	.095890411	.095628415
3 5/8	.099315068	.099043716
3 3/4	.102739726	.102459016
3 7/8	.106164384	.105874317
4	.109589041	.109289617
4 1/8	.113013699	.112704918
4 1/4	.116438356	.116120219
4 3/8	.119863014	.119535519
4 1/2	.123287671	.122950820
4 5/8	.126712329	.126366120
4 3/4	.130136986	.129781421
4 7/8	.133561644	.133196721
5	.136986301	.136612022
5 1/8	.140410959	.140027322
5 1/4	.143835616	.143442623
5 3/8	.147260274	.146857923
5 1/2	.150684932	.150273224
5 5/8	.154109589	.153688525
5 3/4	.157534247	.157103825
5 7/8	.160958904	.160519126
6	.164383562	.163934426
6 1/8	.167808219	.167349727
6 1/4	.171232877	.170765027
6 3/8	.174657534	.174180328
6 1/2	.178082192	.177595628
6 5/8	.181506849	.181010929
6 3/4	.184931507	.184426230
6 7/8	.188356164	.187841530

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TABLE II.—*Decimal for 1 day's interest on $1,000 at various rates of interest, payable annually or on an annual basis, in regular years of 365 days and in leap years of 366 days.*—Continued

Rate per annum (percent)	Regular year 365 days	Leap year 366 days
7	$0.191780822	$0.191256831
7⅛	.195205479	.194672131
7¼	.198630137	.198087432
7⅜	.202054795	.201502732
7½	.205479452	.204918033
7⅝	.208904110	.208333333
7¾	.212328767	.211748634
7⅞	.215753425	.215163934
8	.219178082	.218579235
8⅛	.222602740	.221994536
8¼	.226027397	.225409836
8⅜	.229452055	.228825137
8½	.232876712	.232240437
8⅝	.236301370	.235655738
8¾	.239726027	.239071038
8⅞	.243150685	.242486339
9	.246575342	.245901639
9⅛	.250000000	.249316940
9¼	.253424658	.252732240
9⅜	.256849315	.256147541
9½	.260273973	.259562842
9⅝	.263698630	.262978142
9¾	.267123288	.266393443
9⅞	.270547945	.269808743
10	.273972603	.273224044
10⅛	.277397260	.276639344
10¼	.280821918	.280054645
10⅜	.284246575	.283469945
10½	.287671233	.286885246
10⅝	.291095890	.290300546
10¾	.294520548	.293715847
10⅞	.297945205	.297131148
11	.301369863	.300546448
11⅛	.304794521	.303961749
11¼	.308219178	.307377049
11⅜	.311643836	.310792350
11½	.315068493	.314207650
11⅝	.318493151	.317622951
11¾	.321917808	.321038251
11⅞	.325342466	.324453552
12	.328767123	.327868852

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Exhibit 7.—An act to provide for a temporary increase in the public debt limit, and for other purposes

[Public Law 96-5, 96th Congress, H.R. 2534, April 2, 1979]

Public debt limit. Temporary increase. 31 U.S.C. 757b note.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, during the period beginning on the date of the enactment of this Act and ending on September 30, 1979, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased by $430,000,000,000.

Repeal; effective date. 31 U.S.C. 757b note.

SEC. 2. Effective on the date of the enactment of this Act, the first section of the Act of August 3, 1978, entitled "An Act to provide for a temporary increase in the public debt limit" (Public Law 95-333), is hereby repealed.

SEC. 3. The last sentence of the second paragraph of the first section of the Second Liberty Bond Act (31 U.S.C. 752) is amended by striking out "$32,000,000,000" and inserting in lieu thereof "$40,000,000,000".

United States savings bonds, rate increase, limitation.

SEC. 4. With respect to interest accrual periods beginning after the date of the enactment of this Act, paragraph (3) of section 22(b) of the Second Liberty Bond Act (31 U.S.C. 757c) is amended to read as follows:

"(3) The Secretary of the Treasury, with the approval of the President, may increase the investment yield on any United States savings bonds above the 5½ per centum limitation contained in paragraph (1) so long as such yield does not exceed 7 per centum per annum compounded semiannually."

Report. 31 U.S.C. 1322 note.

SEC. 5. Congress shall balance the Federal budget. Pursuant to this mandate, the Budget Committees shall report, by April 15, 1979, a fiscal year budget for 1981 that shall be in balance, and also a fiscal year budget for 1982 that shall be in balance, and by April 15, 1980, a fiscal year budget for 1981 that shall be in balance, and by April 15, 1981, a fiscal year budget for 1982 that shall be in balance; and the Budget Committees shall show the consequences of each budget on each budget function and on the economy, setting forth the effects on revenues, spending, employment, inflation, and national security.

Presidential alternate proposals to Congress. 31 U.S.C. 11 note. 31 U.S.C. 11.

SEC. 6. (a) If a budget which is transmitted by the President to the Congress under section 201 of the Budget and Accounting Act, 1921, would, if adopted, result in a deficit in fiscal year 1981 or in fiscal year 1982, the President shall also transmit alternate budget proposals which, if adopted, would not result in a deficit.

(b) Such alternate budget proposals shall be transmitted with the budget and, except as provided in subsection (c), shall be in such detail as the President determines necessary to carry out the purposes of this section.

(c) Alternate budget proposals for a fiscal year transmitted under subsection (a) shall include a clear and understandable explanation of specific differences between the budget and alternate budget proposals.

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Exhibit 8.—An act to provide for a temporary increase in the public debt limit, and to amend the Rules of the House of Representatives to make establishment of the public debt limit a part of the congressional budget process

[Public Law 96-78, 96th Congress, H.R. 5369, September 29, 1979]

TITLE I—TEMPORARY INCREASE IN PUBLIC DEBT LIMIT; EXCEPTION TO INTEREST RATE CEILING ON BONDS

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. Public debt limit, temporary increase; establishment as part of congressional budget process. 31 U.S.C. 757b note.

SEC. 101. (a) During the period beginning on the date of the enactment of this Act and ending on May 31, 1980, the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased by $479,000,000,000.

(b) Effective on the date of the enactment of this Act, the first section of the Act of April 2, 1979, entitled "An Act to provide for a temporary increase in the public debt limit, and for other purposes" (Public Law 96-5), is hereby repealed. Repeal. *Ante*, p. 8

SEC. 102. The last sentence of the second paragraph of the first section of the Second Liberty Bond Act (31 U.S.C. 752) is amended by striking out "$40,000,000,000" and inserting in lieu thereof "$50,000,000,000".

TITLE II—ESTABLISHMENT OF PUBLIC DEBT LIMIT AS PART OF CONGRESSIONAL BUDGET PROCESS

SEC. 201. (a) The Rules of the House of Representatives are amended by adding at the end thereof the following new rule:

"RULE XLIX

"ESTABLISHMENT OF STATUTORY LIMIT ON THE PUBLIC DEBT

"1. Upon the adoption by the Congress (under section 301, 304, or 310 of the Congressional Budget Act of 1974) of any concurrent resolution on the budget setting forth as the appropriate level of the public debt for the period to which such concurrent resolution relates an amount which is different from the amount of the statutory limit on the public debt that would otherwise be in effect for such period, the enrolling clerk of the House of Representatives shall prepare an engrossment of a joint resolution, in the form prescribed in clause 2, increasing or decreasing the statutory limit on the public debt by an amount equal to the difference between such limit and such appropriate level. The vote by which the conference report on the concurrent resolution on the budget was agreed to in the House (or by which the concurrent resolution itself was adopted in the House, if there is no conference report) shall be deemed to have been a vote in favor of such joint resolution upon final passage in the House of Representatives. Upon the engrossment of such joint resolution it shall be deemed to have passed the House of Representatives and been duly certified and examined; the engrossed copy shall be signed by the Clerk and transmitted to the Senate for further legislative action; and (upon final passage by both Houses) the joint resolution shall be signed by the presiding officers of both Houses and presented to the President for his signature (and otherwise treated for all purposes) in the manner provided for bills and joint resolutions generally. 31 U.S.C. 1322, 1325, 1331.

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31 U.S.C. 757b. "2. The matter after the resolving clause in any joint resolution described in clause 1 shall be as follows: 'During the period beginning and ending , the public debt limit set forth in the first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) shall be temporarily increased [or decreased] by $ (and any other provision of law providing for a temporary increase [or decrease] in such limit shall not apply).'; with the first two blanks being filled with the beginning and ending dates of the fiscal year or other period to which the concurrent resolution on the budget just agreed to relates, and with the third blank being filled with a dollar figure equal to the difference between the statutory limit on the public debt as set forth in section 21 of the Second Liberty Bond Act and the appropriate level of the public debt as set forth in such concurrent resolution.

31 U.S.C. 1322. "3. The report of the Committee on the Budget of the House of Representatives accompanying any concurrent resolution on the budget under section 301(d) of the Congressional Budget Act of 1974, as well as the joint explanatory statement accompanying the conference report on any concurrent resolution on the budget, shall contain a clear statement of the effect under this rule that the adoption by both the House and the Senate of such concurrent resolution in the form in which it is being reported (and the adoption of the joint resolution thereupon prepared and enrolled under clause 1) would have upon the statutory limit on the public debt. It shall not be in order in the House of Representatives at any time to consider or adopt any concurrent resolution on the budget (or agree to any conference report thereon) if at that time the report accompanying such concurrent resolution (or the joint statement accompanying such conference report) does not comply with the requirements of this clause.

"4. Nothing in this rule shall be construed as limiting or otherwise affecting the power of the House of Representatives or the Senate to consider and pass a bill which (without regard to the procedures under clause 1) changes the statutory limit on the public debt most recently established under this rule or otherwise; and the rights of Members and committees of the House with respect to the introduction, consideration, and reporting of any such bill shall be determined as though this rule had not been adopted.

"Statutory limit on the public debt." 31 U.S.C. 774. "5. As used in this rule, the term 'statutory limit on the public debt' means the maximum face amount of obligations issued under authority of the Second Liberty Bond Act and obligations guaranteed as to principal and interest by the United States (except such guaranteed obligations as may be held by the Secretary of the Treasury), determined under section 21 of such Act after the application of the second sentence thereof, which may be outstanding at any one time."

31 U.S.C. 757b. (b)(1) Clause 1(v)(5) of Rule X of the Rules of the House of Representatives is amended by inserting "(subject to the last sentence of clause 4(g) of this rule)" after "United States".

(2) Clause 4(g) of rule X of the Rules of the House of Representatives is amended by adding at the end thereof the following new sentence: "The views and estimates submitted by the Committee on Ways and Means under the preceding sentence shall include a specific recommendation, made after holding public hearings, as to the appropriate level of the public debt which should be set forth in the concurrent resolution on the budget referred to in such sentence and serve as the basis for an increase or decrease in the statutory limit on such debt under the procedures provided by rule XLIX.".

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(c) Clause 8 of rule XXIII of the Rules of the House of Representatives is amended—

(1) by inserting "(except to the extent that the amendment involved is limited by the third sentence of this clause)" after "mathematically consistent"; and

(2) by adding at the end thereof the following new sentence: "It shall not be in order in the House or in a Committee of the Whole to consider an amendment to a concurrent resolution on the budget, or any amendment to an amendment thereto, which changes the amount of the appropriate level of the public debt set forth in the concurrent resolution as reported; except that the amendments to achieve mathematical consistency which are permitted under section 305(a)(6) of the Congressional Budget Act of 1974 may include an amendment, offered by or at the direction of the Committee on the Budget, to adjust the amount of such level to reflect any changes made in the other figures contained in the resolution.". 31 U.S.C. 1326.

SEC. 202. The first sentence of section 21 of the Second Liberty Bond Act (31 U.S.C. 757b) is amended by inserting before the period at the end thereof the following: ", subject to any increases or decreases in such limit which may from time to time be provided by law (through the congressional budget process as described in rule XLIX of the Rules of the House of Representatives or otherwise)".

SEC. 203. The amendments made by this title shall apply with respect to concurrent resolutions on the budget for fiscal years beginning on or after October 1, 1980. 31 U.S.C. 757b note.

Domestic Finance

Exhibit 9.—Remarks by Under Secretary for Monetary Affairs Solomon, October 19, 1978, before the Public Securities Association, Marco Island, Fla., on management of the public debt, futures contracts based on Treasury securities, and recent international developments

I am pleased to have this opportunity to talk with you about the management of the public debt. I will also comment on the Treasury's concerns with futures contracts based on Treasury securities. Then, I would like to share some thoughts with you on recent international developments.

Debt management

It is certainly obvious to all of you that Treasury financing demands have had a major impact on the credit markets in recent years. In the fiscal years 1977 and 1978 alone the net borrowing requirement of the Treasury amounted to about $113 billion. Of that amount, the Treasury raised about $84 billion of new cash through financing in the credit markets. The bulk of this financing was conducted in a period of rising interest rates.

In managing such a large financing task, this administration has benefitted greatly from the debt management policies which evolved in recent years, and we have tried to adhere to three basic principles in our debt management decisions:

First, to raise the money required to meet the Government's financing requirements in the most efficient manner possible.

Second, to conduct our borrowing in a way that fosters, rather than inhibits, economic stability and sustained growth of the economy.

Third, to work toward a balanced maturity structure, in order to facilitate the orderly managing of the debt in future years.

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Consistent with these principles, we have financed our requirement over the past 2 years primarily by regular auctions of coupon securities and a gradual shift toward longer term financing.

The regularized offering cycles of notes and bonds have made a vital contribution to the successful efforts of the Treasury in meeting our large financing needs. These cycles provided the Treasury with regular access to the various maturity sectors of the market, and allowed investors to plan on these predictable offerings for their investment needs. We think that regularization has encouraged broader investor participation in the Government securities market and has contributed to price stability through a reduction of market uncertainty concerning our financing plans. We anticipate that the cycle offering approach will continue as an integral part of our debt management strategy.

Another marketing device that has facilitated the efficient issuance of Treasury coupon securities has been the auction technique. By allowing investors and speculators to determine the price of regular, moderately sized issues of Treasury securities at competitive auction, we have minimized financing costs and reduced the underwriting pressures on primary dealer organizations.

Under this administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. During the last 2 fiscal years, Treasury's market borrowing via coupon securities totaled $84.8 billion while, at the same time, there was a slight paydown in Treasury bills. Thus, we have avoided adding to the liquidity of the economy at a time when excessive liquidity is being transmitted into increasing prices.

This policy of debt extension has also caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965, the average maturity of the privately held marketable debt was 5 years 9 months. By January 1976, it had declined to 2 years 5 months, because huge amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing large needs for cash of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years 3 months currently.

Debt extension has been accomplished primarily through continued and enlarged offerings of long-term bonds in our mid-quarterly refundings. In this administrations's first refunding, in February 1977, Treasury offered $750 million of 30-year bonds. In our most recent mid-quarterly financing, Treasury offered $1.5 billion of 30-year bonds. The market's acceptance of Treasury bonds had developed rapidly; and the importance of the longer maturity area has been recognized by Congress by providing additional bond authority, which should be sufficient until next spring.

We have also used this new bond authority in the 15-year area, beginning in June 1977 when the Treasury offered $1.5 billion of 15-year bonds. This offering was substituted for a 5-year cycle note and thus represented an interruption in the pattern of 5-year note offerings which was initiated in January 1976. From June 1977 to June of this year, we alternated between 15-year and 5-year offerings on a quarterly basis.

In September, the Treasury offered $1.5 billion of 15-year bonds at a time when market participants might have expected an offering of 5-year notes. In addition to the fundamental objective of accomplishing further debt extension, there were two immediate reasons for this decision. First, our very large cash balance rendered unnecessary the additional cash-raising potential of the 5-year note. Second, market conditions at the time of the decision were particularly favorable for a 15-year bond issue. There had been a significant decline in long-term rates in the several weeks prior to the offering announcement, which reflected strong investor demand coupled with an absence of a meaningful supply of longer dated securities.

It perhaps would be premature to conclude that the recent 15-year bond offering necessarily indicates a shift to a quarterly cycle with this maturity. As our market borrowing needs subside, however, as we continue to move toward smaller budget deficits, the likelihood of such a quarterly cycle is greatly enhanced.

As I mentioned earlier, we are aiming at a more balanced maturity structure in order to facilitate efficient debt management in the future. In this regard, we are aware of a tendency toward some unevenness in our maturity structure for coupon issues. In 1979, for example, the total amount of privately held coupon obligations maturing in

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the second quarter is $9.1 billion, as compared to $19.3 billion maturing in the fourth quarter. This imbalance has arisen partly because of the seasonality of tax receipts combined with our policy of regularized coupon offering cycles. On the one hand, tax collection dates in April and June have reduced Treasury's borrowing requirements or even permitted us to pay down marketable debt in the second quarter. Our coupon issues maturing in that quarter, therefore, have merely been rolled over. On the other hand, our borrowing requirement in other quarters has caused enlarged coupon offerings in those periods.

This situation suggests an increasing use of longer dated cash management bills. The sale of cash management bills in the fourth and first quarters, respectively, with maturities in the second calendar quarter would remove some of the burden on coupon offerings during the earlier quarters. This temporary financing could then be replaced by permanent financing through additions to coupon offerings in the second calendar quarter. This approach, which has often been used by Treasury in the past, acknowledges the large difference in the quarterly flow of tax receipts and represents an effort to distribute the maturity structure more evenly.

Let me conclude this part of my remarks by mentioning that on November 2, 1978, the Treasury will implement the Treasury tax and loan investment program. In May, the Department issued the regulations setting forth the provisions of the program.

With the implementation of the program, the Treasury will return to a cash management strategy aimed at maintaining a fairly constant balance at Federal Reserve banks. This had been our practice prior to the fall of 1974. At that time, the constant Fed balance was being targeted at approximately $2 billion, and the swings in the total cash balances were absorbed by the tax and loan balances. An average of about 20 percent of the Treasury's operating cash was held in Federal Reserve banks and an average of about 80 percent was held in the tax and loan accounts. Since 1974, that proportion has just about reversed. During the initial stages of the new program, we will move gradually toward reducing our balances at Federal Reserve banks and increasing our investments in obligations of depositaries.

A significant market effect of the program is that it will reduce the sudden large changes in Treasury balances with the Federal Reserve banks, and there will be a corresponding reduction in the need for offsetting open market operations by the Fed.

Futures market

I would like to turn now to a number of concerns that the Treasury has with respect to futures markets which are based on Treasury securities.

I am sure you are all familiar with the explosive growth in these markets over the past two years.

Futures trading based on Treasury securities began in January 1976 with futures contracts for 13-week Treasury bills on the International Monetary Market (IMM) of the Chicago Mercantile Exchange. Then, trading in Treasury bond futures began in August 1977 on the Chicago Board of Trade. More recently, in September 1978, futures trading began in 1-year Treasury bills on the IMM. Also, a number of new proposals are now being considered by the Commodity Futures Trading Commission for additional futures contracts based on Treasury debt instruments.

I think it is fair to say that the volume of trading in the Treasury bill futures market and the proliferation of new futures contract proposals based on Treasury securities are much greater than anyone anticipated when Congress first authorized futures trading based on financial instruments in an amendment to the Commodity Exchange Act in 1974.

Current congressional concern about this explosion in financial futures is expressed in Public Law 95-405, which amended the Commodity Exchange Act and was signed by President Carter on September 30, 1978. This new law requires the CFTC to submit to the Treasury Department any applications from a board of trade for designation as a contract market involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof. The act also requires the CFTC to consider the impact that such contract market designations might have on the "debt financing requirements of the United States Government and

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the continued efficiency and integrity of the underlying market for government securities."

The Treasury's concerns with futures contracts based on U.S. Government securities were discussed at length in connection with the congressional hearings earlier this year on the bill just signed by the President. Today, I will just comment briefly on some of our concerns from the standpoint of Federal debt management policy.

The Treasury has not opposed the designation of contract markets involving Treasury bills. We have carefully monitored developments in the bill futures market since its establishment in 1976, and we have not seen any evidence that this market has benefitted the Treasury. However, we have not found sufficient cause to recommend suspension of trading in existing contracts or disapproval of new contract designations.

We have expressed a number of concerns, however, with respect to contract market designations involving Treasury coupon securities. Unlike Treasury bills, which are highly liquid short-term instruments and are actively traded throughout their lives, Treasury notes and bonds are longer term securities which are typically put away in portfolio by permanent investors. Treasury relies on these investors to finance the major portion of the public debt. As these coupon securities are placed with them, there is a diminution of secondary market trading and in the availability of securities for delivery. We are concerned, therefore, that market prices on outstanding Treasury coupon securities, and thus prices on Treasury new issues, could be adversely affected by a large volume of trading in any futures contracts based on Treasury coupon securities.

Also, it is essential that the Treasury maintain the flexibility to finance the public debt at the lowest possible cost consistent with the fiscal requirements of the Government and the needs of the economy. In this regard, Treasury's flexibility could be reduced by the establishment of a futures market which is heavily dependent upon an expected new issue by the Treasury. Clearly, in establishing new markets for futures contracts in Treasury notes, it should not be assumed that the regular issuance of Treasury cycle notes will continue in its present pattern. As I mentioned earlier, just last month the Treasury substituted a 15-year bond issue for the usual 5-year cycle note. While many market participants had expected a 5-year note issue, we did not have to deal with an established futures market in 5-year notes, and we were able to accomplish this change on short notice with minimum market impact.

Treasury debt management flexibility could also be reduced by the existence of futures markets dependent upon the ready availability of outstanding Treasury coupon securities. For example, the Treasury has at times engaged in advance refundings of outstanding Treasury issues, and the Treasury also gave serious consideration recently to purchasing certain outstanding issues to relieve congestion in certain maturity areas of the market. Such debt management operations by the Treasury could result in the unexpected withdrawal from the market of certain securities, or groups of securities, which constituted part or all of the anticipated deliverable supply in the futures market.

The Treasury would certainly welcome the establishment of futures markets in coupon securities if we felt that these markets would benefit Treasury financing. We are concerned, however, that these markets may do more harm than good from the standpoint of the efficient financing of the public debt.

I raise these concerns with the hope of encouraging your expert consideration of them. I know that many of you are active participants in the Treasury futures market and in the Treasury cash market as well. We would welcome any thoughts that you might have.

Recent international developments

I would like now to comment on international economic and financial developments which have an important bearing on the public securities markets in the United States.

The principal developments in the international financial area in the past 2 years have been the very substantial reduction in the OPEC current account surplus, and the emergence of major payments imbalances among the industrial countries leading to strong exchange market pressures as the foremost problem facing the international

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monetary system. My expectation is that the OPEC surplus will continue to decline and that it will not be a major disruptive factor next year. I also expect that we will see significant improvement in payments relationships among the industrial countries and increased monetary stability next year. Both of these developments would imply a reduction in foreign official purchases of U.S. Government securities in 1979.

The OPEC countries accummulated investable surpluses amounting to nearly $180 billion during 1974 - 1977, an average of $45 billion per year. This year, it is likely to be less than half the $34 billion recorded in 1977, and may decline by as much as $10 billion more next year in the absence of an oil price increase. As the OPEC surplus declines, management of OPEC's investment portfolio is becoming increasingly constrained by decisions and commitments made in earlier years, including bilateral and multilateral aid, and commitments to balance of payments financing through IMF arrangements such as the Supplementary Financing Facility which will take effect shortly. Such constraints have required a curtailment of OPEC's discretionary investments elsewhere, including the United States, which has traditionally accounted for some 20 to 30 percent of total OPEC placements. There was no significant increase in OPEC investment in the United States during the first half of 1978. In fact, there was a small decline in OPEC holdings of Treasury securities, although there were increases in other forms of U.S. assets. Preliminary evidence for the second quarter suggests no increase in OPEC's financial assets worldwide; there is no evidence of a shift by OPEC from dollar investments.

If our projections are in the right range, new OPEC discretionary investments in the United States—or any other market—are likely to be quite small.

The emergence in 1977 of a very large U.S. current account deficit, with attendant downward pressures on the dollar, and foreign intervention in an attempt to temper appreciation of certain currencies, has tended at times to create very large flows of foreign official capital into the U.S. Government securities market.

In the first quarter of this year, the dollar remained under heavy pressure in the foreign exchange market as the trade deficit mushroomed to an annual rate of $45 billion, and as concern mounted about our ability to achieve a better balance in the face of rising inflation, extended congressional debate on an energy program and continued divergence of growth rates here and abroad. Foreign exchange market intervention during the quarter led to further increases in foreign holdings of Treasury securities of some $15 billion.

The situation changed sharply in the second quarter. With the trade and current deficits beginning to improve and the dollar showing signs of strength in the exchange markets, the direction of intervention was reversed and foreign holdings of Treasurys fell by some $5 billion. We do not yet have a complete picture of the third quarter, but it appears that there was no appreciable change in foreign holdings of Treasury securities.

What are the prospects for the coming year? We have just gone through an intensive round of discussions at the IMF/IBRD annual meetings. There is quite clearly a convergence of views in the official financial community that a significant improvement in the international payments situtation—and particularly that of the United States—is in prospect. This outlook is based in part on expectations about future policy moves here and abroad. But it is also based in substantial part on steps that have already been taken, and which are now beginning to yield concrete results.

First, we can anticipate a shift in the relative rates of growth of the United States and its major trading partners. Our growth rate next year should be at rates compatible with the expansion of productive activity. At the same time, growth rates in Europe and Japan will pick up somewhat under the impact of domestic stimulus measures. Whereas the U.S. growth rate has been well above the average growth of our major trading partners, in 1979 Europe and Japan should show more rapid growth than the United States for the first time since the 1975 global recession.

Second, the U.S. competitive position has improved sharply in terms of our major competitors as a consequence of exchange rate changes over the past 18 months. On a trade weighted, price adjusted basis, the U.S. competitive position has improved by some 5 to 10 percentage points since early last year in terms of our major trading partners.

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These changes in growth rates and exchange rates are now beginning to affect trade flows, though the real effects continue to be obscured by the immediate price effects of exchange rate changes. Following a solid year of very rapid expansion, the volume of U.S. nonpetroleum imports has been slightly down since February. And since about the beginning of the year, U.S. exports—particularly nonagricultural but also agricultural exports—have been moving up sharply.

The major effects of these changes in growth and exchange rates are still ahead of us. Thus, we expect further improvement in the U.S. trade position and a substantial reduction—perhaps on the order of 30 to 40 percent—in our current account deficit next year. This obviously is a welcome development, and will represent a major contribution to greater international financial stability. But as I mentioned earlier, part of the relatively positive outlook of the Finance Ministers at the IMF was based on expectations about future policy moves. And at this particular point, that largely means moves by the United States.

It is recognized abroad that a major part of the U.S. trade problem lies in the energy sector, and it is accepted that we are at last moving to deal with this problem. It is also recognized that the United States needs to exploit export opportunities more vigorously. Here too, we are embarking on a program to improve our performance.

But what is stressed uniformly is the critical need for the United States to come to grips with its inflation problem and—more than any other factors I have mentioned—our policies and performance in this area will determine the outlook for the international financial situation and the dollar.

The President will shortly announce a comprehensive new anti-inflationary program to supplement—not substitute for—broad fiscal and monetary restraint with direct measures in the wage and price area. As we have unequivocally indicated on many occasions, we have no intention of imposing wage-price controls. But we do need more rigorous and quantitative standards of behavior in the wage-price area, and the application of those standards will be very broad, with a minimum of exclusions. The wage-price standards are just one of a number of initiatives intended to bring more responsible management to Government in order to deal more effectively with the fundamental underpinnings of inflation.

Without dwelling on the program, I would emphasize that the administration is determined to pursue a tight and effective fiscal policy. I am sure that you will agree that our efforts are being channeled in the right direction. In fiscal year 1976, the budget deficit was $66 billion. Last year—under the first budget proposed by President Carter—the deficit was reduced by $16 billion. For this fiscal year, we intend to cut the deficit by at least another $10 billion. And it is the President's intent to make a further major cut in fiscal year 1980. Our budget policy is designed to reduce Government competition with the private sector for real and financial resources. This policy can only be accomplished by holding Federal expenditures to very little real growth during the next 2 years. We recognize that, among our anti-inflation efforts, we will be judged most importantly by our critics on this Administration's commitment to fiscal prudence.

On the basis of the policy measures in prospect and the already partly visible results of policies undertaken to date here and abroad, I believe there is a good prospect for a significant improvement in the international payments and financial situtation—and in the U.S. external position. In this framework, I would anticipate more stable patterns of private capital flows into the United States and, with greater exchange market order, less foreign official acquisitions of dollars in the exchange markets. Combined with very limited amounts of investible funds in OPEC hands, the prospect is, therefore, for substantially less foreign official interest in U.S. Government securities in the coming year.

Exhibit 10.—Statement of Assistant Secretary Altman, February 6, 1979, before the House Ways and Means Committee, on the public debt limit

I am here today to advise you of the need for an increase in the public debt limit. I am also requesting an increase in the authority to issue long-term securities in the market and an increase in the statutory interest rate ceiling on savings bonds. After

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discussing these specific debt management requirements, I would like to comment on our recent issues of securities denominated in foreign currencies. Then, I will discuss the need to strengthen the process by which Congress establishes the debt limit.

Debt limit

Turning first to the debt limit, the present temporary debt limit of $798 billion will expire at the end of March, and the debt limit will then revert to the permanent ceiling of $400 billion. Based on our current estimates, however, the $798 billion ceiling will be exceeded sooner—around March 9. Legislation by that date will be necessary, therefore, to permit the Treasury to borrow to refund maturing securities and to pay the Government's other legal obligations. This assessment on timing is virtually identical to that which I presented to you in testimony last July. Thus, Congress was made aware at that time that the $798 billion limit probably would not be enough to carry us through March 31.

Let me explain why legislative action is needed by early March. The debt subject to limit actually would exceed the $798 billion sooner—by the end of this month—unless we reduce our normal $15 billion cash balance assumption.

As a practical matter, we believe that we can get through this month without any serious debt limit problems, since the assumed $15 billion cash balance is more than we need for this period.

Our cash balance requirements fluctuate substantially, because of the seasonal flows of tax receipts and outlays, but we think that we can safely run the cash balance down to approximately $7 billion at the end of this month. At the end of February last year our cash balance was $7.4 billion. On this basis, the debt subject to limit could be kept below $798 billion until approximately March 9.

In the circumstances, I strongly urge that congressional action on the debt limit be completed as soon as possible.

Over the longer term, our current estimates of the amounts of debt subject to limit at the end of each month through the fiscal years 1979 and 1980 are shown in the attached table. The table indicates that the debt subject to limit will increase to $833 billion at the end of September 1979, and to $893 billion on September 30, 1980, assuming a $15 billion cash balance on those dates. These estimates are consistent with the budget estimates which the President submitted to Congress on January 22. The usual $3 billion margin for contingencies would raise these amounts to $836 billion in September 1979, and $896 billion in September 1980. Thus, the present debt limit of $798 billion should be increased by $38 billion to meet our financing requirements through the remainder of fiscal 1979 and by an additional $60 billion to meet the requirements in fiscal 1980.

The amount of the debt subject to limit approved by Congress in the September 1978 budget resolution is also $836 billion for the fiscal year ending September 30, 1979. Yet, since the budget resolution does not have the force of law, it will be necessary for Congress to enact a new debt limit bill before the Treasury can borrow the funds needed to finance the programs approved by Congress last September.

Bond authority

I would like to turn now to our need for an increase in the Treasury's authority to issue long-term securities in the market without regard to the 4¼-percent ceiling.

Under this administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. This policy has caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965, the average maturity of the privately held marketable debt was 5 years 9 months. By January 1976, it had declined to 2 years 5 months, because huge amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing large needs for cash of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years 4 months currently.

Debt extension has been accomplished primarily through continued and enlarged offerings of long-term bonds in our mid-quarterly refundings as well as routine offerings of 15-year bonds. These longer term security offerings have contributed to a

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more balanced maturity structure of the debt in order to facilitate efficient debt management in the future. Also, these offerings have complemented the administration's program to restrain inflation. By meeting some of the Government's new cash requirements in the bond market rather than the bill market, we have avoided adding to the liquidity of the economy at a time when excessive liquidity is being transmitted into increasing prices.

Congress has increased the Treasury's authority to issue long-term securities without regard to the 4¼-percent ceiling a number of times, and in the debt limit act of August 3, 1978, it was increased from $27 billion to the current level of $32 billion. To meet our requirements in the remainder of the fiscal year 1979, the limit should be increased to $40 billion; and to meet our requirements in the fiscal year 1980, the limit should be increased to $55 billion.

The Treasury to date has used about $30 billion of the $32 billion authority, which leaves the amount of unused authority at about $2 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $23 billion increase in the bond authority would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1980. We are currently issuing long-term securities at an annualized rate of approximately $15 billion.

Savings bonds

In recent years, Treasury has recommended frequently that Congress repeal the ceiling on the rate of interest that the Treasury may pay on U.S. savings bonds. The current 6-percent statutory ceiling was enacted by Congress in 1970. Prior to 1970 the ceiling had been increased many times as market rates of interest rose and it became clear that an increase in the savings bond interest rate was necessary to provide investors in savings bonds with a fair rate of return.

Mr. Chairman, we do not feel that an increase in the interest rate on savings bonds is necessary today. Yet, we are concerned that the present requirement for legislation to cover each increase in the rate does not provide sufficient flexibility to adjust the rate in response to changing market conditions. The delays encountered in the legislative process could result in inequities to savings bond purchasers and holders if interest rates rise on competing forms of savings.

The Treasury relies on the savings bond program as an important and relatively stable source of long-term funds. On that basis, we are concerned that participants in the payroll savings plans and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with comparable forms of savings. In this regard, market interest rates increased substantially in 1978 and are currently close to the historic highs reached in the 1973–74 period when the savings bond interest rate was increased from 5½ percent to 6 percent. Moreover, there was a significant increase in savings bond redemptions last year. Savings bond sales exceeded redemptions by $748 million in 1975, $793 million in 1976, and $840 million in 1977. However, in 1978, as market rates of interest increased, redemptions exceeded sales by $236 million. The resulting cash loss to the Treasury, which has been steadily increasing in the past few months, must be made up by increasing the amounts the Treasury borrows in the market, and the Treasury is currently paying significantly higher interest rates on its market borrowings. If this situation continues, it may be essential to increase the savings bond interest rate in order to avoid further substantial cash drains to the Treasury and permanent damage to the savings bond program.

Any increase in the savings bond interest rate by the Treasury would continue to be subject to the provision in existing law which requires approval of the President. Also, the Treasury would, of course, give very careful consideration to the effect of any increase in the savings bond interest rate on the flow of savings to banks and thrift institutions.

While I continue to believe that the savings bond interest ceiling should be removed, I recognize that it may not be possible to gain prompt approval by Congress of a proposal to eliminate the ceiling. Thus, I am requesting that the ceiling be increased at this time from 6 percent to 6½ percent. This one-half of 1 percent increase should be enough to provide us with the flexibility we need at this time.

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Foreign currency issues

Let me turn briefly to the issuance of Treasury securities denominated in foreign currencies.

As you know, Mr. Chairman, on November 1, 1978, the Treasury announced its intention to issue up to $10 billion in securities denominated in foreign currencies. The purpose of these borrowings is to acquire foreign currencies which the United States can use in its exchange market operations.

The securities are issued pursuant to section 16 of the Second Liberty Bond Act (31 U.S.C. 766), which provides specific authority for the Secretary of the Treasury to issue securities denominated in foreign currencies. These are public debt securities and, as such, are direct obligations of the United States. The amount of their issuance is subject to the public debt limit.

On December 15, 1978, the Treasury issued the first of these obligations, in the form of 3- and 4-year notes denominated in deutsche marks, in an aggregate amount of approximately DM 3.0 billion (1.6 billion dollar equivalent). Just recently, on January 26, 1979, the Treasury issued 2½- and 4-year notes denominated in Swiss francs totaling SF 2.0 billion (1.2 billion dollar equivalent). The interest rates which the United States is paying on these obligations are substantially below current domestic interest rates. The notes were offered through the central banks of Germany and Switzerland, acting as agent on behalf of the United States. There were no commissions associated with these offerings, and this is unprecedented in both countries for a public offering of a foreign borrower.

There were special features associated with our German and Swiss offerings which were intended to restrict final investors. In each offering, the notes were placed only with residents of the country in whose currency they are payable. Also, only very limited transferability was permitted among such residents. Further, the German Bundesbank and the Swiss National Bank maintain a register of beneficial owners, and transfers are only effected after each central bank checks to insure that the transferee is a resident of the respective country. These limitations will help minimize the extent to which dollar holdings might be converted into foreign currencies for the purchase of the securities, which would tend to counter the intended purpose of the offerings.

The decision to sell these foreign-denominated securities, as part of the November 1 program, was made to help deal with the severe and persistent disorders in foreign exchange markets, and excessive declines in the dollar, which were undermining our efforts to control inflation and damaging the climate for investment and growth in the United States.

Debt limit process

Mr. Chairman, I would now like to comment on the process by which the public debt limit is established.

It is well recognized that the present statutory debt limit is not an effective way for Congress to control the debt. In fact, the present debt limit process may actually divert public attention from the real issue—control over the Federal budget. The increase in the debt each year is simply the result of earlier decisions by Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved congressional budget procedures and provided a more effective means of controlling the debt. That Act requires congressional concurrent resolutions on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

Moreover, the statutory limitation on the public debt occasionally has interfered with the efficient financing of the Federal Government and has actually resulted in increased costs to the taxpayer. For example, when the temporary debt limit expired on September 30, 1977, and new legislation was not enacted on the new debt limit until October 4, and again when the limit lapsed from July 31, 1978, to August 3, 1978, Treasury was required in the interim periods to suspend the sale of savings bonds and other public debt securities. The suspension of savings bonds sales, in particular,

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resulted in considerable public confusion, additional costs to the Government, and a loss of public confidence in the management of the Government's finances.

Accordingly, I believe that the public debt would be more effectively controlled and more efficiently managed by tying the debt limit to the new congressional budget process. I hope that we can work together to devise an acceptable way to do this.

Public debt subject to limitation, fiscal year 1979, based on budget receipts of $456 billion, budget outlays of $493 billion, unified budget deficit of $37 billion, off-budget outlays of $12 billion

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1978		Actual	
Sept. 30	22.4	773	
Oct. 31	15.5	778	
Nov. 30	12.9	784	
Dec. 29	16.3	790	
1979			
Jan. 31	15.1	792	
		Estimated	
Feb. 28	15	804	807
Mar. 30	15	809	812
Apr. 30	15	807	810
May 31	15	822	825
June 29	15	810	813
July 31	15	819	822
Aug. 31	15	826	829
Sept. 28	15	833	836

Public debt subject to limitation, fiscal year 1980, based on budget receipts of $503 billion, budget outlays of $532 billion, unified budget deficit of $29 billion, off-budget outlays of $12 billion

[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1979		Estimated	
Sept. 28	15	833	836
Oct. 31	15	843	846
Nov. 30	15	856	859
Dec. 31	15	857	860
1980			
Jan. 31	15	858	861
Feb. 29	15	874	877
Mar. 31	15	881	884
Apr. 30	15	872	875
May 31	15	889	892
June 30	15	878	881
July 31	15	887	890
Aug. 29	15	897	900
Sept. 30	15	893	896

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Exhibit 11.—Statement of Assistant Secretary Altman, March 2, 1979, before the Senate Committee on Banking, Housing and Urban Affairs, on controls over Federal credit programs

I welcome this opportunity to discuss the administration's proposal for a system to control Federal credit programs, which the President announced in his January budget message. The new system would improve legislative and executive controls over credit programs and improve our focus on their overall financing requirements and their impacts on credit markets.

Under the administration's proposal, annual limits on new lending under direct and guaranteed loan programs would be established in the regular budget and appropriations process. An overall, annual limit would be proposed in the President's budget, as well as a limit on each program. Aggregate ceilings could be set in the congressional budget resolutions. Legally binding limitations for each individual budget account would be set in regular annual appropriation acts.

The major impact of the new system would be on loan guarantee programs. Opportunity now exists for review and control of direct loans in the regular budget and appropriations process, since most direct loan programs are included in the budget totals. Loan guarantee programs, however, largely escape the budget process, since loan guarantees do not result in budget outlays (except in cases of default or where explicit subsidy payments are provided).

The new control system would not apply to Government-sponsored enterprises such as the Federal National Mortgage Association (FNMA), the Farm Credit System, and the Federal Home Loan Bank System. These agencies are entirely privately owned and are largely self supporting. Thus, they differ significantly from Federal loan guarantee programs which are administered by federally owned agencies and are effectively backed by the credit of the U.S. Treasury. However, even though the Government-sponsored enterprises would be excluded from the new Federal credit program control system, their activities should be taken into account in determining the overall Federal impact on total credit demands and on the allocation of credit to particular sectors of the economy.

Growth in Federal loan guarantees

Let me turn now to the specific problems of loan guarantees, which have been the principal focus of the congressional committees interested in credit program controls. The table attached to my statement shows an estimated $333 billion of guaranteed loans outstanding at the end of FY 1980, an increase of $37.4 billion from the 1979 level. Thus, in FY 1980 the net demands on financial markets to finance Government loan guarantee programs will total $37.4 billion. As shown in the table, these demands have increased rapidly in recent years, from $16.2 billion in FY 1976 to $20.5 billion in FY 1977, $25.1 billion in FY 1978, and an estimated $32.8 billion in FY 1979.

By comparison, the net demands on financial markets to finance the Federal budget deficits during this period have been declining. They fell from $66.4 billion in FY 1976 to $45.0 billion in FY 1977, $48.8 billion in FY 1978, and an estimated $37.4 billion in FY 1979 and $29 billion in FY 1980. Thus, while budget deficit financing is expected to be cut by more than half in this 4-year period, the net off-budget financing required for loan guarantee programs will more than double.

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Net increase in Federal and federally assisted borrowing from the public
[Fiscal years; billions of dollars]

Year	Federal borrowing from the public				Federally assisted borrowing from the public				Total Federal and federally assisted borrowing from the public
	Budget deficit	Off-budget deficit[1]	Other means of financing[2]	Total[3 6]	Guaranteed obligations	Sponsored agency obligations[4]	Deduct to avoid double counting[5]	Total	
1970	2.8	-	2.6	5.4	6.4	10.7	5.6	11.5	16.9
1971	23.0	-	-3.6	19.4	16.1	1.5	3.4	14.2	33.7
1972	23.4	-	-3.9	19.4	18.8	5.0	4.6	19.2	38.6
1973	14.8	.1	4.4	19.3	15.2	8.8	-.7	24.7	44.0
1974	4.7	1.4	-3.1	3.0	10.1	14.9	4.0	21.0	24.1
1975	45.2	8.1	-2.4	50.9	16.4	11.9	14.4	13.9	64.7
1976	66.4	7.3	9.2	82.9	16.2	5.3	6.5	15.0	97.9
T.Q.........	13.0	1.8	3.3	18.0	2.7	1.7	3.3	1.1	19.1
1977	45.0	8.7	-.1	53.5	20.5	7.0	2.0	25.5	78.9
1978	48.8	10.3	-.1	59.1	25.1	24.1	13.8	35.4	94.5
1979[e]	37.4	12.0	-9.4	40.0	32.8	13.3	12.7	33.4	73.4
1980[e]	29.0	12.0	-2.0	39.0	37.4	16.9	12.4	41.9	80.9
Net change 1970-80....	353.6	61.6	-5.1	410.0	217.7	121.1	82.0	256.8	666.8
Outstanding 9/30/80....				689.9	333.4	146.5	96.4	383.5	1,073.4

Source: Special Analysis E of the fiscal year 1980 Budget of the U.S. Government, January 1979.

[e] Estimate.

[1] Deficit of off-budget Federal entities. Consists largely of Federal Financing Bank borrowings to finance off-budget programs.

[2] Consists largely of changes in Treasury cash balances.

[3] Consists of borrowing by Treasury and minor amounts by other Federal agencies.

[4] Consists largely of Federal National Mortgage Association and the Federal home loan bank and farm credit systems.

[5] Largely Federal and sponsored agency purchases of guaranteed obligations.

[6] 1976 figure excludes retroactive reclassification of $471 million of Export-Import Bank asset sales to debt.

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A major reason for the proliferation of guarantees is the common misconception that they are cheaper and less risky to the Federal Government than direct loans. There is, however, no inherent difference, from the Federal viewpoint, between the costs and financial market effects of these two forms of credit.

The argument favoring guarantees relies primarily on experience with the largest and best known guarantee program—the FHA's single family mortgage insurance program. This successful program, enacted during the great depression of the 1930's, assured private lenders that they could safely make long term, low down payment mortgage loans at reasonable interest rates, thus filling an important credit gap. Today, the FHA program's objectives are being achieved increasingly by private financial institutions without the need for Government intervention.

Unfortunately, FHA insurance has been the exception. A review of the programs covered in Special Analysis F of the Budget belies the argument that most guaranteed loan programs pose minimal costs to the Federal Government. Indeed, most involve substantial subsidies to borrowers and direct costs to the Treasury and, ultimately, the taxpayer.

Let me enumerate some of these subsidies:

Principal subsidies.—In some cases, the Federal Government has extended loan guarantees with the expectation of paying part or all of the principal amount of the loan. The guaranteed loan is equivalent, therefore, to an outright grant of taxpayer funds. An extreme case is the public housing program, involving $15 billion of public housing note and bond guarantees (debt service contracts) outstanding. It is unlikely that public housing projects will generate sufficient revenues to service any of this debt. As a result, the Federal Government probably will make all interest and principal payments on this $15 billion.

Interest subsidies.—Other guaranteed loan programs involve direct interest subsidies—for example, rural community facilities, and subsidized private housing—in addition to the subsidy implicit in the guarantee itself.

Default costs.—Beyond these principal and interest subsidies, all guaranteed loans obviously involve Federal assumption of credit risks and thus potential costs to the Federal taxpayer in the event of unanticipated default.

Let me make a final comparison between direct loans and guaranteed loans. All loans involve three basic functions—assuming risk, supplying funds, and processing the loan.

Some argue that guarantees involve the Government only in risk assumption, and that the private sector supplies the funds and handles the paperwork. Yet another examination of the types of guarantees outstanding indicates that certain agencies issuing guarantees perform all three of these functions.

Specifically, several agencies, including HUD, HEW, and Agriculture, make direct loans but then convert them into guarantees. In making the direct loans, they assume the risk, supply the funds, and handle the processing. They then can sell the loans to private parties, however, continuing to guarantee them. A second example involves HUD's urban renewal program, which provides direct loan authority. Here, a commitment to make a direct loan is treated as a guarantee and sold by borrowers into the market.

Another misconception is that guaranteed loans are still largely financed by local lending institutions, with minimal Government involvement, and thus have little net impact on the securities markets. In fact, the $37.4 billion net financing requirements for loan guarantees in FY 1980 will be largely financed directly in the securities markets: An estimated $11.4 billion will be financed through the Federal Financing Bank, and thus by the Treasury; $10.5 billion will be financed by GNMA mortgage-backed securities; $3.1 billion by public housing bonds and notes; and additional amounts of securities market financing will be required for certain other guarantee programs such as the SBA, Farmers Home Administration, and the Maritime Administration.

Improved standards for issuing guarantees

All of us also should address the need for better standards under which guarantee authority is provided by Congress in the first place.

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It is clear that program agencies should be given more specific guidelines on the circumstances under which guarantees are to be provided and the related terms and conditions of them. Giving these agencies broad guarantee authority and then expecting them to resist the inevitable demands for guarantees unavoidably leads to serious problems of control over guarantee totals and general misallocation of our limited credit resources.

Let me discuss the basic circumstances in which guarantees are issued and make some suggestions for tightened loan guarantee standards and how they would help with the broader problem of controlling loan guarantee programs.

Credit need test.—Most loan guarantee programs are intended to facilitate the flow of credit to borrowers who are unable to obtain credit in the private market. The needs of more creditworthy borrowers are expected to be met in the private market without Federal credit aid. To achieve this purpose more effectively, and to provide a built-in control over program growth, enabling legislation should be more specific on requiring evidence that borrowers cannot obtain credit from conventional lenders. Specifically, we think that legislation should require the guarantor agency to certify that, without the guarantee, borrowers would be unable to obtain credit on reasonable terms and conditions.

Coinsurance.—In addition, guarantee programs are often intended to induce private lenders to extend loans on more favorable terms to marginal borrowers. The borrowers involved generally can obtain loans on their own, but only on costly and otherwise disadvantageous terms. In these cases, 100 percent guarantees don't make sense because they would lower the interest rate below that paid on unguaranteed loans to creditworthy borrowers for the same purposes. Doing so would stimulate a demand for guaranteed loans by creditworthy borrowers who do not need Federal credit aid.

To avoid such excessive demand for guarantees, we favor a much greater use of partial, rather than 100 percent guarantees. In the future, legislation generally should limit the guarantees to assume, say, 90 percent of the loan. Private lenders then would charge a higher rate of interest commensurate with project risk and with the rates charged on unguaranteed loans. Such risksharing, or coinsurance, by private lenders would contribute to the development of more normal borrower-lender relationships, would prompt lenders to exercise greater surveillance over the loans, and would stimulate increased conventional lending for the economic activities involved.

Guarantees of tax-exempt bonds.—The Treasury opposes Federal guarantees of tax-exempt municipal bonds. They create a class of securities which is stronger than the Federal Government's own securities. Like Treasury securities, they would be backed by the full Federal credit but, unlike Treasurys, they would be exempt from Federal taxes. In addition, such guarantees would convey the benefits of both the Federal credit and the tax exemption to high-income-tax payers—the principal buyers of tax-exempt securities. Also, tax-exempt guarantees are an ineffective means of delivering Federal aid to local governments, since much of the benefit goes to high-income investors and since the financing of Federal programs in the municipal market competes directly with other State and local bond issues for essential local public facilities and increases the cost of financing the facilities. For these reasons, we believe that municipal bonds should only be guaranteed if they are taxable securities.

Fixed interest rates.—Another example of poor program structure, which leads to program control problems, involves loan guarantees where borrowers pay a fixed interest rate, and the Federal agency pays the difference between that rate and the market rate. Thus, as interest rates rise, there is an automatic increase in the Federal subsidy and in the demands on the Federal budget. The benefits to the assisted borrower are thus determined by fluctuations in the market rather than by changes in the borrower's real needs.

Excessive financing costs.—Also to be avoided are guarantee programs which are financed directly in the securities markets at disproportionately high costs because of the small size or poor timing of the issue, the lack of investor familiarity with the program, or other special marketing factors. Many of these problems have been cured by financing such guaranteed obligations through the FFB.

Equity participation.—Many guarantee programs involve circumstances where borrowers could take equity positions in the projects being financed, and these

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guarantee programs should encourage them to do so. Requiring borrowers to have such a stake would help avoid excessive demands for guarantees, help assure more efficient projects, and help protect the interests of the Federal Government as guarantor. This could be accomplished by a legislative requirement that the amount of guaranteed and unguaranteed loans not exceed, say, 90 percent of the value of the project being financed.

Other loan terms and conditions.—Demands for guarantees will also be excessive if the authorizing legislation does not contain specific restrictions on such terms and conditions as maximum maturities, guarantee fees, reasonable assurance of repayment, and default procedures.

This is not to say that Federal credit assistance programs should not contain subsidies—indeed, that is their purpose—but the legislation should be carefully drafted so that the subsidies provided are by design, not chance, and are directed at specific needs.

In short, I believe that more effective congressional control over loan guarantee programs can be accomplished by adopting standards which build that control into the structure of each guarantee program. I recognize that this is not an easy task, particularly since there are more than 100 different loan guarantee programs which fall under the jurisdiction of many different subcommittees of the Congress.

In the executive branch, the Office of Management and Budget and the Treasury Department strive to assure a uniform application of standards in the process of reviewing proposed guarantee legislation. Within Congress, however, it may be unrealistic for each interested subcommittee to develop the intense focus on guarantee standards which is essential to this improved control. Accordingly, it may be worthwhile for such a responsibility to be lodged in one committee of the Congress. Alternatively, the Congress could take the approach taken in the Federal Financing Bank Act or the Government Corporation Control Act and enact omnibus legislation to establish credit program standards.

Exhibit 12.—Summary and recommendations of a joint Treasury/Federal Reserve study of Treasury futures markets, May 1979

Introduction

The rapid growth in recent years of futures trading in U.S. Government securities raises a number of questions of importance to the Treasury and to the Federal Reserve:

- Does futures trading in U.S. Government securities affect adversely the efficiency and integrity of the underlying cash market for those securities?
- Is the trading of futures contracts which depend on deliverable supplies of Government securities likely to constrain the Treasury in its debt management decisions?
- Will the exchanges and the Commodity Futures Trading Commission (CFTC) be capable of maintaining effective surveillance of financial futures markets, particularly as essentially duplicative contracts trade simultaneously on several exchanges?
- Is there a danger that unsophisticated investors will not fully appreciate the risks inherent in futures contracts whose names suggest the backing of the U.S. Treasury?

The September 30, 1978, legislation (Public Law 95-405), which renewed the authority of the CFTC to regulate futures markets, directs the Commission to solicit the advice of the Treasury and the Federal Reserve before authorizing any additional futures contracts that specify delivery of U.S. Government securities. The act also requires the Commission to consider the impact of such futures trading on the debt management requirements of the Treasury and on the efficiency and integrity of the market for U.S. Government securities. Confronted with the need to comment on several pending contract proposals, yet lacking a body of reseach on which opinions could be firmly grounded, the Secretary of the Treasury and the Chairman of the Board of Governors wrote the CFTC in October 1978, suggesting an immediate

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Treasury-FRB study and requesting a moratorium on new authorizations of Treasury futures contracts until the study could be completed.

Since then the staffs of the Treasury and the Federal Reserve have conducted over 30 interviews with a wide variety of participants in both the cash and futures markets for Government securities. The findings from these interviews, from current staff studies, and from previous studies of futures markets are summarized below under three broad headings:

1. The potential benefits from these markets;
2. The potential problems which they might pose for the efficient operation of the underlying market in U.S. Government securities, for the Treasury in its debt management, and for particular categories of investors; and
3. Conclusions and recommendations.

The discussion of the findings is preceded by a brief introduction to the institutional background of financial futures. A much more complete discussion of the potential strengths and problems of futures markets in contained in a separate staff study, which also includes a summary of the interviews with market participants and a more extensive treatment of the regulatory strucutre of the industry.

The Institutional Background

1. The Product

A futures contract is an agreement to buy or sell a particular good—traditionally, an agricultural commodity—on some specified *future* date, but at a price determined *now* by competitive bidding on the floor of an exchange. Since late 1975, futures contracts on a number of financial instruments have been introduced, including ones based on 3-month and 1-year Treasury bills, which trade on the International Monetary Market (IMM) of the Chicago Mercantile Exchange (CME), and one based on long-term Treasury bonds, which is listed on the Chicago Board of Trade (CBOT). Applications by these and other exchanges for additional contracts on Treasury securities are now pending before the CFTC. Some of them are essentially duplicative of the bill and bond contracts, but others propose futures contracts on Treasury notes ranging in maturities from 2 to 7 years.

Trading volume in the 3-month bill and bond contracts has grown rapidly, averaging over 4,000 contracts a day for each. (A single bill contract is for $1 million face value of bills; each bond contract, for $100,000 par value of bonds.) The number of contracts outstanding (the "open interest") recently has been roughly 55,000 in the case of the 3-month bills and 45,000 for the bonds. Interviews with market participants indicate that this trading activity has been largely speculative, although there is evidence of hedging by investors seeking protection against the risk of interest rate changes. (The difficulty in distinguishing hedging from speculating is discussed below.)

Despite the heavy trading volume, typically only a relatively small number of contracts culminate in actual delivery on each maturity date, the remainder having been liquidated by offsetting trades. This pattern of few deliveries is common to all organized futures markets; i.e., markets on which standardized contracts for future delivery are traded on regulated exchanges, which require all positions to be "marked to market" daily. By contrast, deliveries are the rule rather than the exeception for forward contracts, which are unregulated agreements between two parties to exchange a good or security at an agreed-upon price on some specified future date, and which can be tailored to meet individual needs.

2. Exchanges

Exchanges are nonprofit associations whose membership is generally composed of individuals. The privileges of exchange membership include the right to trade on the floor for one's own account, the right to collect a brokerage fee for executing trades for others, and the right to vote for the members of the governing body of the exchange. The governing body—composed of both members and nonmembers—is ultimately responsible for enacting and enforcing the rules of the exchange and, thus, for much of the self-regulation of the futures industry.

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Each exchange maintains a clearinghouse which acts as a third party to every trade. That is, the clearinghouse is directly or indirectly the other party in every futures contract: the buyer to every seller, and vice versa. In this sense, the exchange stands behind every contract.

Exchange members acquiring contracts for their own account or for their customers must deposit assets with the exchange equal to a certain proportion of their contractual obligations. Such deposits, which can take several forms including cash, Treasury securities or, in some cases, a letter of credit, are commonly referred to as margins. They are, however, really in the nature of a bond that guarantees eventual performance of contract terms rather than a downpayment that limits the use of credit to purchase a security. The exchanges have exclusive authority to set margin levels.

The equity value of the exchange member's margin account will, of course, vary with the market price of contracts. At the end of each trading day the clearinghouse "marks to market" each account; i.e., the effects of the day's price movement are calculated. If a loss is incurred which depletes the margin account, the exchange member is notified and he must send a certified check before the start of business the following morning to restore the account to its required level.

The exchanges also require their members to obtain margins from their customers. These accounts are also marked to market, but the procedures members use for their customers on margining and marking to market do not have to be uniform.

3. The CFTC

The Commodity Futures Trading Commission, established in 1975, is composed of a Chairman and four other Commissioners appointed by the President and confirmed by the Senate to serve staggered 5-year terms. The CFTC has broad regulatory authority over futures trading, and it must approve all futures contracts traded on U.S. exchanges, ensure that the exchanges enforce their own rules (which it must review and approve), and direct an exchange to take any action needed to maintain orderly markets whenever it believes that an "emergency" such as market manipulation exists. [A recent court decision in the case of the March 1979 wheat contract on the CBOT, however, has raised important questions as to the adequacy of the CFTC's authority to require exchanges to take emergency actions.]

Potential Benefits from Financial Futures

Futures markets can benefit society by (1) reallocating risk to those more tolerant of it, and (2) aggregating information and making it available to everyone at a low cost. This section will describe how these services are provided by futures markets and examine whether they could be provided just as well without such markets, particularly in the case of financial futures. Also, it will note some of the other uses for financial futures beyond "hedging" and "speculating," as those terms are usually defined in textbooks and in trade literature.

1. Hedging and speculating

An individual or institution whose business requires holding inventories of any good, finished or in process, may wish to be protected from the risk of adverse price movements of the good in question. A farmer might reasonably feel more competent to grow crops than to forecast their prices. A bank might be better able to assess the creditworthiness of a small business than to gauge what the cost of its own funds will be a year in the future. The farmer might want to protect himself ("hedge") against the risk of unfavorable price changes by locking in now the prices at which he could sell his harvested crop at some later date and the bank might want to hedge against the risk of a rise in the interest rate it must later pay on its CD's (certificates of deposit). By the same token, individuals who have a preference for risk bearing and who specialize in forecasting prices might be willing to "speculate" by contracting now to buy the yet-to-be-harvested crop or the planned future issue of CD's.

Speculators, however, provide social functions other than relieving hedgers of risk. In order to survive, they must devote substantial resources to the generation of information concerning future events. As they act on this information, they transmit it to the public via the price system. For example, if their private information indicates

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that the world wheat harvest will be poor, they effectively communicate that information as they bid up the price at which they contract now to buy wheat from farmers at harvest time.

2. Advantages of futures

The hedging and speculating activities described above could take place even if there were no futures markets. Forward contracts could be negotiated on an individual basis. Or, in the case of the anticipated wheat shortage, speculators could buy wheat from grain elevators and hold these stocks in inventory themselves, thus speculating in the spot market. But futures markets permit these activities to be carried out more efficiently. The existence of a central market (the exchange) reduces the search costs involved in bringing hedgers and speculators together. The fact that the exchange's clearing corporation interposes itself between the contracting parties further reduces costs by lowering the risk to each side that the other party will default. By publicly providing up-to-the-minute price quotes on all trades, futures markets permit the rapid and widespread dissemination of the information possessed by individual speculators. Finally, purchase of a futures contract does not involve the inventory costs associated with purchase of a commodity in the spot market.

However, these advantages are less important in the case of financial futures. A variety of forward contracts exist, including "when-issued" trades of new securities, standby contracts (put options) on GNMA securities, and repurchase agreements. Hedgers and speculators can be brought together efficiently through the highly developed dealer network. That same network provides for the transmittal of the latest price quotes. Also, financial instruments do not require the storage and transportation costs required for tangible commodities.

Despite the availability of these alternative avenues for hedging and speculating in financial markets, futures trading still has some distinct advantages, such as the role of the exchange as guarantor of every contract. Furthermore, short sales of securities, though possible in the spot market, are cheaper to execute in a futures market since the short does not have to pay a fee to borrow the security. The very fact that financial futures have grown as rapidly as they have in the presence of these alternatives suggests that there are cost advantages to using futures contracts.

Whether financial futures markets increase the availability of information is moot, since the yield curve in the spot market already embodies the views which speculators hold regarding the future course of interest rates. But to the extent that financial futures markets encourage more speculation by lowering the cost of doing so, they also lead to the production of a greater amount of information than would otherwise be available. In other words, while the spot market yield curve may incorporate all available information, that yield curve may itself be altered by the existence of financial futures. There is disagreement among economists, however, as to whether the yield curve will be "improved," i.e., whether it will more accurately anticipate the actual future course of interest rates and whether the additional information generated through futures trading will represent an optimal use of society's resources.

3. Other uses for financial futures

The dichotomy of hedging and speculating fails to capture the variety of motivations for using futures. Even the distinction between hedging and speculating is itself often unclear. For example, the decision to incur the costs of establishing a hedge may reflect one's forecast that prices will move adversely and thus involve an element of speculation. Furthermore, unless the maturity of the futures contract coincides exactly with the time when the crop is harvested or the CD's are issued—to continue the earlier example—a hedged position will not be a riskless one. Nonetheless, hedging does reduce risk exposure, and the fact that there are few "pure hedgers" in the textbook sense operating in financial futures markets need not imply that these markets are not being used to reduce risks.

Financial futures may also be used for arbitrage purposes. An investor may at times find it profitable to, say, sell a 6-month Treasury bill and replace it with a 3-month bill and a tandem 3-month Treasury bill futures contract. Such a trade is "riskless" but it is not "hedging." [It is arbitrage, in that it helps to drive futures and spot market rates

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into proper alignment and in that the arbitrageur knows his profits with certainty after consummating the trade.] On the other hand, one may decide to speculate that the shape of the yield curve will change by taking simultaneous long and short positions in different delivery months for the same security. While such "straddles" are speculative, they typically involve less risk than simple open positions. The riskiness of these and other trades can really be judged only in the context of one's entire portfolio, not in isolation.

Potential Problems with Financial Futures

The preceding section described some of the uses to which financial futures can be put and some of the benefits— both to individuals and to society at large—which can accrue from these instruments. In order to decide whether the development of financial futures should be encouraged, however, it is necessary to weigh the purported benefits against any potential problems. A variety of such potential problems have been identified. This section attempts to assess their seriousness.

1. The impact on spot markets

A basic concern has been that futures trading in Government securities will have a destabilizing effect on prices in the spot market for these securities and that investors on whom the Treasury normally relies to finance its debt may be dissuaded from bidding in Treasury auctions if prices become less stable, thus leading to higher yields or costs to the Treasury. It is important from a policy perspective to distinguish the case in which destabilizing effects might arise even if futures markets are perfectly competitive from the case in which a small group of investors looms large enough in the markets to have a significant impact on prices.

In the perfectly competitive case, the usual argument for a destabilizing influence from futures goes as follows: (1) Futures trading encourages speculation by reducing the costs involved; (2) speculators are likely to drive futures prices to levels not justified by market fundamentals; (3) wide price swings in futures markets will be transmitted to spot markets via arbitrage. Whatever the intuitive appeal of such reasoning, empirical studies of both agricultural and financial markets have not been able to prove that there is greater price variability in spot markets during periods in which the good or security in question was traded on a futures market.

A supplementary argument (again, in the competitive case) stresses the danger that, should investors be unable to close out futures positions because prices have already moved the daily limit, they may try to cover their positions with offsetting spot market transactions, thereby imparting additional price variability to the spot market. So far, Treasury bill futures prices have never moved their daily limit. Treasury bond futures have done so on a number of occasions, but market participants indicated in interviews that this appeared to be essentially a response to abruptly changed expectations about cash market prices. They did not believe there was any substantial spillover to the spot market from events originating in the futures market.

Still a third possible avenue for futures to have a destabilizing effect on spot prices is by drawing funds into the futures market which would otherwise be used in the spot market. The resulting thinness of the spot market could then make spot prices prone to wider swings. However, since securities dealers generally use the futures markets in conjunction with the spot markets, e.g., for hedging or for arbitrage, their activities should not contribute to any such diversion of funds. Moreover, many of the speculative positions taken by individuals in futures markets would probably have never been taken at all in the cash markets, given the costs of carrying the actual securities.

There is a related concern sometimes expressed that financial futures will divert funds from third markets, particularly the stock market. But buying a futures contract, for which securities in one's portfolio may be pledged as initial margin, does not reduce the volume of funds available to underwrite real investments. In sum, under the assumption of perfectly competitive futures markets, fears that futures trading in financial instruments will disrupt the spot markets have not been documented.

These fears cannot be so lightly dismissed once the competitive assumption is relaxed, however. In speaking of possible ways in which prices (futures or spot) could be distorted, no distinction will be made between a "squeeze" and a "corner."

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According to the CFTC Glossary, a "corner" means controlling enough of a commodity so that its price can be manipulated, while a "squeeze" refers to a situation in which those who are short cannot repurchase their contracts except at a price substantially higher than the value of the contract in relation to the rest of the market. These definitions are inexact and do not necessarily have any legal significance.

The possibility of either a corner or a squeeze in the case of the 3-month bill, for example, arises from the fact that the futures contract can be satisfied only with a single maturity, over which command of the available supply is not beyond the resources of a large securities dealer. The "available" supply may be considerably smaller than the total supply to the extent that a substantial portion of each auction goes to the Federal Reserve and to foreign central banks and other noncompetitive bidders who are not likely to be sensitive to price changes in deciding whether to resell. In some auctions during the last year, the Fed and foreign official accounts absorbed all but about $1 billion of the new 3-month issue.

On, say, a $3 billion issue, an individual dealer could take $750 million and still stay within the Treasury guideline of not alloting more than 25 percent to a single bidder. If, in addition, a dealer also took a sizable long position in the futures market, bought the new 3-month issue on a "when-issued" basis from other bidding or planning to bid in the auction, and had previously acquired a long position in the outstanding deliverable bill (auctioned originally as a 6-month issue), he might well be able to build a long position in the new bill that actually exceeded total auction awards to investors other than the Federal Reserve and foreign official accounts.

Interviews with market participants suggested that dealer positioning strategies of this kind may have succeeded in squeezing the secondary market price on one or two new bill issues during 1978. While market estimates of the resulting distortion in yield in those operations range from 10 to 40 basis points, such judgments cannot be effectively tested, due to the many other special factors that were influencing supply-demand relationships in the cash bill market at the same time. It should be noted, though, that observed spreads among immediately adjacent bill maturities did not widen to these proportions.

The Treasury bond contract differs from the bill contract in that an entire "market-basket" of securities is eligible for delivery. Although the basic trading unit is a bond with a $100,000 face value at maturity and an 8 percent coupon, any Treasury coupon issue can be delivered if it has at least 15 years to maturity (or to first call). The contract's settlement price is adjusted if other than 8 percent coupons are delivered.

Possibilities for the manipulation of Treasury bond prices, through joint action in the cash and bond-futures market, appear to be minimal, given the sizable number of issues deliverable under the current contract. While the market-basket approach thus reduces one major potential problem of financial futures, it also reduces one of the major benefits—that is, the uncertainty created as to which issue will ultimately be delivered makes the contract less useful for hedging. In the case of long-term bonds, this problem may be more hypothetical than real, given the flatness of the yield curve at the long end. However, it may pose a problem for the use of the market-basket approach in the intermediate portion of the maturity spectrum, where some of the proposed new contracts fall.

2. Constraints on Treasury

The central point to emerge from the above section is that, in the face of a relatively small deliverable supply of the security specified in a futures contract, the possibility of corners or squeezes leading to disruptive price movements in the spot market is a real one. The Treasury, in turn, could be hurt in the longer run if investors began to shun the market for its debt because of such factors. While the Treasury has the ability to prevent a squeeze by issuing more of the deliverable security, the Treasury should not be so constrained in its debt management decisions by problems in markets for financial futures.

If new contracts were approved for Treasury notes, the chances of problems arising that would make the Treasury feel constrained in its debt management actions might well be increased. Notes are not issued every week as bills are, and the outstanding supply in the proposed contract maturity areas is not as great as for the bond contract.

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Were there futures contracts on, say, a 4-year note, trading now with maturities extending into 1981, the question would arise whether the Treasury ought to feel obligated to plan to issue such securities 2 years from now.

An appreciation of the Treasury's need for flexibility in debt management can be gained by considering the different problems which it faces at times of large deficits and of small ones (or of surpluses). With a rapidly expanding debt in recent years, the Treasury shifted from bill financing to regular intermediate note issues to raise new money as it sought to avoid a rapid buildup in the supply of short-term debt, which would have resulted from the combination of deficit financing and shortening of the outstanding debt with the passage of time. A large increase in a bill offering taken to forestall a squeeze in a bill futures contract would be at cross-purposes with this goal. As the rate of growth of the debt shrinks, on the other hand, as budget deficits decline, the Treasury may interrupt or terminate some of its regular offerings in the intermediate note area. In fact, the Treasury interrupted the 5-year note cycle and certain other note issues in recent quarters, because of declining cash needs.

Market participants have generally argued that the Treasury should not feel constrained to tailor its debt offerings to the requirements of futures markets. But the Treasury cannot be unconcerned with the possibly disruptive effects of its actions on the Government securities markets. Whether the Treasury could feel free to ignore the needs of futures markets in making debt management decisions, thus, would depend on (1) how effectively the exchanges meet the requirements of the Commodity Exchange Act and the CFTC guidelines regarding the adequacy of deliverable supply and (2) how futures markets react to such things as abrupt changes in the size of deliverable supplies. A key consideration is the ability of the exchanges to cope with situations of that kind. The exchanges do have specific rules and procedures for dealing with such emergencies, but the question is how aggressively they would implement them.

3. Possible dangers to specific groups of investors

The bank regulatory agencies must naturally be concerned with the dangers that financial futures might pose for banks which deal in these instruments. There is evidence that financial futures can be used by banks effectively to hedge portions of their portfolios against interest rate risk. The difficulty is in determining whether a given bank's futures position acts to reduce or increase interest rate risk (i.e., whether the position constitutes a hedge or is speculative). Such a determination cannot be made by looking at a futures transaction in isolation, or even by viewing a futures transaction along with a corresponding cash position. Rather the risk of a futures position must be judged against the interest rate risk of the bank as a whole (including the risk of off-balance-sheet commitments) and not relative to any single transaction.

No bank has yet failed or required supervisory attention. as a result of involvement in financial futures. However, trading in forward, and standby contracts for GNMA securities has threatened the solvency of some banks, and injudicious trading in commodities futures was the proximate cause of the failure of a foreign banking subsidiary of a large U.S. bank. Caution should be used in drawing inferences based on these experiences. The forward market, which lacks the mark-to-market procedure of futures, allows large gains or losses to accrue without the discipline of daily margin settlements. And the bank failure associated with commodities futures involved a large number of questionable banking practices.

Apart from banks, small investors are another specific group for whom financial futures may cause problems. One fear is that these investors will not distinguish futures contracts on Government securities from the underlying securities themselves. Additionally, such participants may not recognize that the highly leveraged nature of futures can make them extremely risky. In such circumstances, unsophisticated investors can become especially vulnerable to aggressive, if not ill-advised, selling tactics by brokerage firms promoting futures. While these dangers may be real ones, once again it is important to add that organized futures markets have more built-in safeguards for small investors than do forward markets.

Conclusions and Recommendations

Given the particular concerns that prompted the Treasury/Federal Reserve study of markets for Treasury futures, the resulting conclusions and recommendations are

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focussed on three principal issues: (1) The adequacy of deliverable supply for existing and proposed contracts; (2) the problems that might develop from a rapid proliferation of contracts for Treasury securities in general, and of substantially similar contracts on more than one exchange in particular; and (3) the additional safeguards that might be needed to protect the growing number of investors being encouraged to participate in Treasury futures transactions. On each of these issues, recommendations are first listed and then explained.

1. Adequacy of deliverable supply

Proposed new coupon contracts.—When reviewing requests for new futures contracts in Treasury coupon issues, it is recommended that the CFTC adhere to the following general guidelines on deliverable supply:

- The CFTC should consider not just the width of the maturity range defining issues eligible for delivery, but also the number of already outstanding issues that will move into that range as the contract approaches delivery, the size of those issues, and their likely availability in the secondary market (as suggested by the length of time they have been outstanding and their distribution by type of holder). These questions should be addressed explicitly in the analysis prepared for the Commission by its staff when new contract designations are being considered. Studies of how the prices of given issues vary relative to those of adjacent issues will help to shed light on this question of availability.
- In no case should the CFTC approve a contract that depends for its deliverable supply solely on a particular security yet to be issued.
- When contracts specify a relatively narrow maturity range for the deliverable supply, approval should also be withheld on new contracts if the deliverable supply of already outstanding maturities consists of only small amounts of closely held issues.
- To assure that the exchanges regularly review the terms of all outstanding contracts in relation to changes in the structure of marketable Federal debt, the CFTC should reestablish a "sunset" provision for new contracts requiring them to be reviewed and reauthorized every few years.

The IMM has stated that the substantial variability of the Treasury yield curve in the intermediate maturity range would create major market uncertainties concerning the value as a hedge of any new note contract that specified a broad "market-basket" of deliverable supply. For this reason it has restricted the definition of deliverable supply for its proposed 4-year note contract to issues with maturities ranging from only 3 years 9 months to 4 years 3 months. While the exchange acknowledges that this relatively narrow band of deliverable maturities might create some risk of an occasional shortage in deliverable supply, it asserts that if such a development should occur, this would not represent a significant problem.

Exchange officials note that they operate under explicit rules for dealing with deliverable supply shortages, are perfectly prepared to use these procedures when needed, and can require settlement of a contract in cash if this becomes necessary. Consequently, they see no reason why an unexpected shortage in deliverable supply should disrupt the cash market, or exert special pressure on the Treasury or the Federal Reserve to deal with the shortage. At the same time, they are concerned that any significant broadening of the deliverable supply for the 4-year note contract would substantially reduce its appeal to investors as an instrument for hedging.

Notwithstanding this IMM contention, the record of commodities exchanges in dealing with deliverable supply shortages in nonfinancial commodities has been inconsistent. Contracts in Treasury futures pose special problems, since shortages in the deliverable supply can develop with little warning close to the contract delivery date. For example, if an auction of an expected issue were suddenly canceled or substantially reduced in size only a few days before contract delivery, a squeeze on the deliverable supply could develop very unexpectedly. If the deliverable supply were eliminated completely, the exchange would be forced to call for an emergency measure such as settlement in cash. But if the supply were simply reduced significantly below expectations, the exchange and the CFTC might be inclined to temporize, leading to sharp adjustments in cash market rates. In such a situation, the Treasury

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could be placed in the difficult position of deciding whether to follow through on, or forego, a debt management action which would significantly reduce the deliverable supply of a maturing futures contract.

The risk that squeezes in futures markets might develop and inhibit Treasury debt management flexibility would be reduced if contracts authorized by the CFTC involving delivery of intermediate-term securities were required to adopt a suitable "market-basket" approach to deliverable supply. The fact that some exchanges plan to use this approach on their proposed intermediate-term contracts suggests that they do not see it as a major defect in the contracts.

Existing 1-year bill contract.—Because its deliverable supply depends wholly on a single new security not yet issued, the existing 1-year bill contract should be modified to assure a broader deliverable supply or, in the alternative, withdrawn.

The existing contract in 1-year Treasury bill futures entails a significant risk of an insufficient deliverable supply because the only issue eligible for delivery is the newly auctioned 1-year bill. Thus, for any given 1-year auction, there is no certainty as to the amount of, or even the issuance of, the bill until about a week before delivery on the futures contract. Any Treasury decision not to roll over, or to reduce significantly the size of the new bill consequently produces an immediate deliverable supply problem, only shortly before the contract delivery date.

The recent postponement of the Treasury's April year-bill auction (necessitated by the congressional delay in extending the Federal debt ceiling) provided an example of how unforeseen developments can arise shortly before delivery. As a result of that postponement, the IMM was forced to limit trading in the April futures to transactions for closing out positions and to introduce a standby emergency procedure for cash settlement. At the last moment, the Treasury did finally issue the bill, before cash settlement became necessary.

Since trading in the year-bill futures contract has generally been quite light, and the open position in the April maturity was small, the delay in making settlement exerted no evident deleterious effect on the cash market. But the experience did dramatize the extreme vulnerability of any contract that relies for its deliverable supply solely on a security yet to be issued.

The deliverable supply of the 1-year bill contract might be expanded, for example, by making the previous 1-year issue, already outstanding, deliverable as well. However, any broadening of the maturities in the supply base would make the contract somewhat less efficient as an instrument for hedging. With contract months for 3-month bill futures now running beyond 1 year, it appears that investor needs to hedge against potential changes in short-term rates can be reasonably well accommodated in that more liquid market. Thus, a withdrawal of the 1-year contract would be an alternative resolution of this potential problem.

Existing 3-month bill contract.—Because the 3-month bill contract has become so well established and so actively used in its present form, a redefinition of deliverable supply at this juncture seems unwarranted. However, in view of the concerns expressed by market participants that the 3-month contract has been vulnerable to squeezes under certain conditions, steps should be taken to minimize these possibilities through improved data collection and monitoring of interactions between the futures and cash markets.

Some market participants perceived particular instances where, in their judgment, the deliverable supply for the 3-month bill contract was squeezed. The particular conditions that were cited for creating this possibility were a combination of restricted market supply (resulting from heavy preemptive demands in the auction for new 3-month bills from both the Federal Reserve and foreign central banks), and strong interest-inelastic investor demands to hold the deliverable bill (because it fit their particular maturity needs). Although some market participants assert that the margin of interest-sensitive investors willing to sell the deliverable bill and switch to higher yielding alternatives is always sufficient to deter any serious manipulation of bill futures prices, the risk of a squeeze seems real enough to suggest the implementation of additional steps that will further minimize this possibility.

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During the month before delivery, the CFTC should routinely collect data on cash and forward positions in the deliverable issue from any entity which has large open positions in the futures contract. The CFTC has already indicated that in special situations, when requested by the Treasury or the Federal Reserve Board, it would be prepared to provide data on a strictly confidential basis showing any large positions in specific futures contracts approaching delivery that are held by Government securities dealers who report to the Federal Reserve. This information will help to supplement the more general data on positions in futures and forwards that the Federal Reserve soon expects to obtain on a daily basis from its reporting dealers. Knowledge that these improved reporting and surveillance procedures are in place should place a further constraint on any major market participant who might otherwise be tempted to try to exert a squeeze on the deliverable supply.

In addition, since the percentage of Treasury bill offerings accounted for by the combination of competitive and private noncompetitive awards has declined significantly in recent years, the Treasury has decided to modify a rule which until now has allowed allotment to a single bidder in a Treasury auction of as much as 25 percent of the announced amount of the public offering. The new rule will permit a maximum allotment to any single bidder of up to 25 percent of the combined amounts of the competitive award and the private noncompetitive award. This new base excludes Treasury securities allotted to the Federal Reserve in exchange for maturing securities held both for its own account and for the accounts of foreign official institutions.

Over time this rule modification should broaden the competitiveness of the auction process and contribute to improved distribution of new security issues. The new rule applies to all Treasury security offerings.

The Treasury will also require bidders in its bill auctions to report on the tender form any net long position of more than $200 million taken prior to the auction in the bill being offered. Such a position would include bills acquired through "when-issued" trading and futures and forward transactions, and (in auctions of new 3-month bills) holdings of the outstanding bill (auctioned previously as a 6-month issue) that carry the same maturity as the new bill. These data will be taken into consideration by the Treasury when awarding new bills in order to reduce the potential for undue concentration and to contribute to improved distribution. This new reporting requirement recognizes the rapid expansion of trading in Treasury bill futures, as well as bill trading on a "when-issued" basis occurring between the announcement and offering dates on auctions.

The alternative of having the Treasury or the Federal Reserve act directly to modify potential squeezes on the deliverable supply of 3-month bills—either through a Treasury increase in the size of the new bill auction, or Federal Reserve sales of the outstanding issue from its portfolio—is not acceptable. While there may be occasions when the Treasury should add to the share of its marketable debt represented by 3-month bills, such actions ought to be taken only as needed to implement the Treasury's general debt management objectives; they should not be initiated to help resolve the particular needs of the commodity exchanges.

Similarily, the Federal Reserve should not be expected to sell 3-month bills from its portfolio to help counter a developing market shortage in the issue deliverable on the maturing bill futures contract. Since the early 1950's the Fed has consistently avoided intervention in the Government securities market for the purpose of adjusting spreads between yields on closely adjacent issues. Earlier experience had shown that any pattern of Federal Reserve market intervention initiated for purposes not clearly seen to be for the implementation of monetary policy tended to create uncertainties about what the System was trying to do, and how its substantial market power would be used to influence prevailing rate relationships. There is a risk that when confronted with such uncertainties dealers and other market professionals will become less willing to take positions in Treasury securities and to operate on reasonable price spreads—thus reducing the general efficiency of the market.

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2. Potential risks of contract proliferation

In view of the differences in self-regulation among the various commodity exchanges and the limited staff resources available to the CFTC for monitoring and surveillance, it is recommended that—

> The CFTC proceed gradually in authorizing additional contracts for financial futures. In the untested intermediate-term sector, for example, a first step might be to authorize only one note contract, on one exchange, with a range of eligible maturities sufficient to provide a reasonable "market-basket" of deliverable supply. Further, the CFTC should not designate new contract markets on more than one exchange for essentially identical contracts unless it has reached formal agreements with the exchanges involved to provide uniform reporting of positions in such contracts to the CFTC and to establish uniform emergency procedures that would be implemented jointly and coincidently at the request of the CFTC.

A gradual approach would give the CFTC time to enhance its surveillance capacity and would help to demonstrate whether an intermediate note contract, designed conservatively, could elicit an active investor interest without increasing the potential for a squeeze on the deliverable supply.

Even under the best circumstances, the extension of trading in Treasury futures to new maturity sectors and to additional exchanges would require careful, step-by-step implementation and close surveillance of results. In the circumstances that exist, the task appears to be more complicated, since some exchanges have less clearly defined rules than others, and the philosophies with which they implement these rules vary. In addition, for the CFTC to provide the close surveillance that would be required to do an effective job of monitoring additional, essentially duplicative contracts on several exchanges, it would apparently need an expansion of staff with expertise in financial markets.

Uncertainties about the adequacy of deliverable supplies produced by the prospect of contract proliferation are greatest for the proposed intermediate-term contracts, since none of these is yet trading. Nevertheless, pending requests for additional bill contracts also raise similar questions. The proposed AMEX bill contract seeks to minimize competition for deliverable supply with the existing IMM contract by making bills maturing in the first month of the quarter eligible for delivery—rather than those maturing in the third month, as is the case of the IMM contract. However, the IMM in its contract designation has authority to trade additional months. Also, the 3-month and 1-year bill futures contracts being requested by Comex specify issues for delivery that would be substantially overlapping with the existing IMM contracts.

It can be argued, in principle, that the combined demands for delivery generated by several overlapping futures contracts will not be significantly greater than those generated where only a single contract is being offered. But it seems more likely that a proliferation of contracts would lead, in practice, to enlarged total demands for delivery. In their requests for additional contracts, the exchanges seeking CFTC approval of overlapping contracts have asserted that they do not believe a proliferation would diminish trading volume on existing exchanges, since they expect their marketing and promotional activities to expand overall demand.

A larger demand for deliveries would mean that there would be a correspondingly larger volume of short positions outstanding just prior to delivery date. This might in turn be viewed as an added potential for profiting from a market squeeze, particularly if market participants thought they could build up a relatively large long position on several exchanges, without attracting the same attention that a similar total position would attract if it were concentrated on a single exchange. To guard against this possibility the CFTC, before permitting contract proliferation should have in place procedures that assure regular checking of positions being taken by particular operators on more than one exchange. This may require reporting of smaller position totals on single exchanges than is now the case.

If the CFTC were to authorize essentially similar contracts on several exchanges at about the same time, it would be important to assure that consolidated position data reported from these exchanges was carefully evaluated, and that, in cases where

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emergency procedures had to be implemented, identical procedures were implemented on each exchange at the same time. There can be no assurance that exchanges will respond to a given emergency in a coordinated manner unless the CFTC by written agreement is authorized to require such action. Specifically, the CFTC should specify by agreement with the relevant exchanges identical emergency procedures for essentially comparable contracts—including rights of substitution, changes in margin, and other measures to encourage a liquidation of open interest and, if need be, a suspension of trading. Such procedures should also be given greater publicity so that market participants could gain a better understanding of them. This would also avoid a competitive devaluation of self-regulatory standards.

3. Safeguards for investors

In view of of the rapid growth in Treasury futures and the potential for widespread participation by individual investors—

> Further study of investor protection and exchange regulation being conducted jointly by the CFTC, the Treasury, and the Securities and Exchange Commission should proceed. Among the issues to be explored should be appropriate customer suitability standards, margin requirements, and position limits. In addition, the CFTC and the exchanges promoting futures contracts should make clear that futures contracts based on Government securities are not obligations of the U. S. Treasury. To avoid any confusion on this question, the exchanges should not use pictures of the Treasury building or of Treasury securities in their promotional material.

The posting of margin and daily marking to market are important aspects of futures exchanges that are designed to protect all participants. Such safeguards substantially reduce the credit risks associated with transactions for future delivery, are helpful in encouraging good management control, and significantly reduce the likelihood that harmful situations will develop. Unfortunately, however, the existing reporting system on particular transactions does not appear sufficient to preclude unethical practices from occasionally occuring within a trading day. Serial tapes, which record the prices and quantities of all transactions as they occur, would help to eliminate the potential for such abuse. Hence the CFTC should continue to encourage the use of serial tapes by the exchanges.

As existing contract markets for Treasury futures expand and additional contracts are offered, it seems quite likely that a growing range of participants will be attracted to these markets—some of whom may not have particularly strong financial positions. Existing safeguards and procedures, including the taking of margin and daily marking to market, appear to afford adequate protection for those involved in most cases. However, although clearing members are required by the exchanges to post margins and mark-to-market, they are not required to use uniform margin and marking-to-market procedures for their own customers. Thus, in some cases, individual customers and/or clearing members may be exposed to undue risk.

Some firms have, nevertheless, established customer suitability standards of their own and have required considerably larger margin on certain types of accounts for which they undertake transactions. Additional efforts in this direction—and perhaps the development of more formal suitability standards—should be encouraged.

Some participants have indicated that they were contracted by over-zealous representatives of firms that were active in the marketing of futures who appeared to have an insufficient understanding of futures transactions. At present this does not appear to be a serious problem, and it is an expected outcome when one market is expanding rapidly at a time when profitability and employment in other financial markets have been steady or shrinking. It does seem appropriate, however, for the CFTC and the exchanges to explore approaches that could strengthen the surveillance of smaller dealer firms. Periodic reviews of general sales and marketing techniques could also prove beneficial. And it seems appropriate for the CFTC and the exchanges to undertake a program that would inform the public about the risks associated with such highly leveraged transactions, since these may not be sufficiently emphasized by

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private firms and individual salespersons. Such a program would also be helpful in clarifying emergency procedures and reasons for their possible implementation.

Exhibit 13.—Testimony of Secretary Blumenthal, June 21, 1979, before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs, on the administration's program for financial reform

I appreciate this opportunity to discuss with you the administration's program for financial reform. On May 22, 1979, the President outlined in a message to the Congress broad legislative objectives to promote fairness to small savers, facilitate stability in housing finance, and modernize depository institution services. This program coincides in many respects with S. 1347, which was introduced jointly by the distinguished chairmen of this subcommittee and of the full Senate Banking Committee.

The Nation's financial system has been undergoing dramatic change, with regulatory change drifting along behind. The regulators administer a system born in the banking crises of the 1930's. Since that time, the quality of our regulatory mechanisms and the health of our financial institutions have improved greatly. Yet many of the old rules remain with us, and some new constraints have been imposed.

The current system of deposit interest rate controls, which was expanded considerably in a series of steps beginning in 1966, was intended to help insulate savings institutions, and thus the mortgage markets, from the effect of disintermediation caused by competition from banks in times of sharply escalating interest rates. Since that time, a series of major studies conducted by the administration and the Congress have reviewed this system. All have found it wanting.

Over a year ago, the President established an interagency task force, chaired by the Treasury, to look again at this set of problems. All concerned members of the executive branch and all regulators of depository institutions were represented. The task force has reported to the President. It concluded that the ceilings are—

Ineffective in preventing sharp changes in the flow of funds to savings institutions and the housing markets,
Unfair to the small saver, and
Conducive to inefficiencies in the marketplace.

The plain fact is that this system works badly.

Mr. Chairman, the studies have gone on long enough. The marketplace has not waited upon governmental action. It is changing all around us, while those who believe the Congress should not act now continue to defend a status quo that no longer exists. The pressure on the earnings of savings institutions has grown, and it will not stop. The holes in the regulatory dike created by the competition for funds from unregulated borrowers are too numerous to be plugged. The Congress must act now to make the pace of change orderly and to give savings institutions the new powers they need to remain healthy and perform their public functions.

I would like to discuss briefly with you some of the findings of the task force.

The flow of credit

The ceilings have not been successful in protecting thrift institutions and housing credit from the effects of rising interest rates, although they have had some impact. The regulatory ceilings and the 25-basis-point differential in favor of savings institutions have reduced the competition for deposits from commercial banks; but during periods of rising interest rates they have not prevented a flow of savings to unregulated competitors, such as money market funds, and to securities issued directly by borrowers, including Treasury securities. Savers have exhibited an increasing unwillingness to be limited to the returns allowed under the Regulation Q ceilings.

In the high-interest-rate periods of 1969 and 1974 there were very serious bouts of disintermediation for savings institutions—especially in the money center areas. In 1969, the flow of funds to savings institutions deteriorated steadily and by early 1970

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had become a net outflow. In 1974, the annual rate of growth of savings deposits dropped to 3 percent in the third quarter from the 9-percent level of late 1973.

After each high-interest-rate period, the depositing public becomes more sensitive to alternative short-term investment opportunities. New institutions spring up to accommodate their needs. Once created, they stand ready to drain funds early in the next high-interest cycle. That was the experience in 1974 and in early 1979. At the end of 1978, for example, assets of the money market funds stood at $10.9 billion. By the end of April 1979, they had ballooned to $20.3 billion. There has been increasing discussion of, and some experimentation with, issuing low-denomination municipal securities. Similarly, Sears has announced that it is considering issuing low-denomination debt securities from its stores. New uninsured outlets for savings will continue to proliferate so long as the Regulation Q ceilings prevent the insured depository institutions from competing at market rates.

Corporations have also begun to borrow in larger amounts directly from the household sector. New money raised by both financial and nonfinancial corporations in the commercial paper market averaged less than $800 million per year from 1961 through 1965 and did not exceed $1.6 billion in any year. In the years immediately following the extension of deposit rate controls in 1966, the average new money raised in the commercial paper market was over $4.7 billion and exceeded $11 billion in 1969. As of the end of 1978, commercial paper outstanding totaled almost $85 billion.

In a period of our national growth characterized by tremendous demand for housing, these developments are not encouraging. Moreover, disintermediation has implications for the safety and soundness of thrift institutions as well as for housing finance. If a thrift institution with a portfolio of low-yielding mortgages were to be faced with sharp increases in deposit rates, its whole revenue base would become unprofitable. So long as it borrows short-term funds and lends long-term funds, that result is a constant risk.

During the 1970's, thrift institutions, in response to the authorization of new, longer term certificates of deposit, tried hard to reduce their vulnerability to the withdrawal of deposits. They decreased sharply the percentage of their deposit liabilities represented by passbook savings, which can be withdrawn on demand. Between 1968 and 1978 the percentage of deposit liabilities at savings and loan institutions represented by passbook savings dropped from 77 percent to 32 percent.

In spite of this progress, the danger of disintermediation created pressure for exceptions. In 1973, ceilings were removed for certificates of deposit of $100,000 or more. Similarly, in June 1978, as rates were rising and fears of disintermediation increased, thrifts and banks were authorized to sell $10,000 minimum denomination 6-month certificates of deposit with a ceiling rate that fluctuated with the 6-month Treasury bill rate—the so-called money market certificate. The 25-basis-point differential was originally maintained for the money market certificate. This instrument has been enormously popular. By the end of April 1979, $146.3 billion had been invested in money market certificates, about half of which had been issued by savings and loan associations. At that time they accounted for about 17 percent of total deposit liabilities at savings and loan associations, and an even higher percentage in money centers.

The money market certificate experience is instructive in considering the relationship between housing credit and the system of savings institutions specializing in mortgage finance. There is no question that these certificates were an important factor in maintaining the flow of funds to housing in the last half of 1978. Their very popularity made them a source of growing concern as interest rates climbed and an increasing percentage of the deposit base was rolled over into money market certificates. Finally, in March 1979, the bank and thrift regulators eliminated the compound interest features of the certificates and eliminated the differential at rates above 9 percent—an effective reduction of nearly 50 basis points. The result was a significant slowing of the growth of money market certificates at savings institutions, and in April 1979 (always a month of slow growth in deposits because of income tax payments) there was a net outflow of funds of about $1.5 billion (excluding interest credited).

The defenders of interest rate controls have emphasized the importance of the ceilings—i.e., relatively low deposit interest rates—to housing. But comparing the

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experience of 1973-74 and 1978-79 indicates that the ceilings breed disintermediation, while deposit interest rates that are responsive to market rates—like the money market certificate—maintain the flow of funds to thrifts.

At the same time, the money market certificate is plainly not a sufficient answer to the problem of disintermediation. Further changes are needed.

Impact on small depositors

The current system is manifestly unfair to the small depositor. Large depositors receive market rates because of the exemption from the ceilings for CD's of $100,000 or more. Others with enough money to invest a portion for longer periods can take advantage of the higher rates on CD's of 4 years or more as well as Treasury notes and bonds. Those with at least $10,000 can buy money market certificates and Treasury bills. But the small depositor who needs the liquidity of a passbook savings account is stuck with the 5¼-percent ceiling (soon to be raised to 5½ percent on July 1). Of course, the greater liquidity of a passbook may require some sacrifice in yield, but the current disparity between short-term market rates and the passbook ceiling remains very great.

For example, the passbook ceiling at thrift institutions is currently 5¼ percent. A person in a 30-percent marginal Federal income tax bracket would receive an after-tax yield of about 32.3 percent; but when this return is adjusted for inflation, which was over 9 percent in 1978, the return is a negative 5⅓ percent. This discourages savings, preventing many Americans from improving their standard of living in the future. And it is cruel to our older citizens, many of whom depend in part on the income from savings for their livelihood.

This inequity in the treatment of depositors is not accidental; it responds to the realities of the financial markets. If large depositors are not offered yields which are competitive with other investment instruments, they will rapidly shift their funds elsewhere. Thus, to be viable, the ceilings can only apply to the household depositor for whom there are few suitable alternatives. In that sense, the current structure of deposit-rate ceilings is a regressive tax.

The losses to savers from deposit ceilings have been substantial. One study, by Professor David H. Pyle of the University of California at Berkeley, concluded that between 1968 and 1975, Regulation Q ceilings resulted in a loss to depositors of $22 billion. More recently, Professor Edward Kane of Ohio State University estimated that between 1968 and 1979, Regulation Q ceilings cost $42 billion in lost interest, and rate restrictions on all types of financial instruments resulted in a loss of $55 billion in interest. Kane estimates that $19 billion was lost by people over the age of 65.

Market inefficiency

Inefficiency results when goods and services are not produced at the minimum attainable cost. Placing ceilings on the rates that banks and thrifts can pay for deposits, while leaving them free to earn market rates of return on loans, prevents the market from rewarding efficient financial institutions and penalizing the inefficient. Inefficiency becomes sheltered by a Federal umbrella. Efforts to restrict competition by controlling deposit interest rates encourage competition on the basis of other factors—gifts, free services, and more convenience in the form of more branch offices and longer hours. This raises the cost of the intermediation function further, since the cost to the depository institution of providing the extra services frequently exceeds the value the depositor places on the services he receives. Many depositors would prefer to receive interest income, which they can spend as they choose, rather than having to accept this "implicit interest."

The future—financial innovation and the housing markets

It seems clear that the trends discussed above will wax rather than wane. Deposit interest rate controls have fostered the development of new institutions and markets ready to meet the demands of the customer. They have grown in rapid spurts when interest rates have risen. But they have not contracted when interest rates decline and have become a permanent feature of our financial system.

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Moreover, the housing credit markets and Federal housing policies have been seeking alternative sources of credit, making housing less sensitive to changes in the flows of funds to thrift institutions. This has led to a significant change in emphasis in the public sector's support of housing finance. Originally, public sector programs were designed to increase the efficiency of the mortgage market; since the mid-1960's, however, public sector programs have emphasized direct market intervention.

The Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation have supplied mortgage credit in significant volume since the mid-1960's. In 1965, FNMA holdings of home mortgages amounted to $2.5 billion; by 1976 these holdings amounted to $26.9 billion. FHLMC holdings of home mortgages increased from about $400 million in 1970 to $3.9 billion in 1976. Total Federal agency holdings of home mortgages (including the holdings of on-budget agencies such as the Government National Mortgage Association, the Farmers Home Administration, the Federal Housing and Veterans Administrations, and the Federal land banks) increased from $6.4 billion in 1965 to $35.5 billion in 1976, or by about 455 percent in little over a decade. The rate of growth in these mortgage holdings was most pronounced in the periods of disintermediation. Currently, preliminary data show that total Federal agency holdings of home mortgages as of the final quarter of 1978 amounted to about $44 billion.

The public sector has also become a significant indirect supplier of mortgage credit over the last decade or so. This has taken place largely through Federal home loan bank advances to savings and loan associations and the rapidly expanding use of federally guaranteed securities for the purpose of financing home mortgage pools. The advances of the Federal home loan banks to savings and loan associations have increased sharply in periods of disintermediation. Thus net advances peaked at $5.5 billion in 1966, $9 billion in 1970, and $19.2 billion in 1974. Thus far in 1979, advances outstanding have reached $32 billion.

Over the same period, mortgage pools, for which the interest and principal payments are guaranteed by GNMA, also grew notably—from about $100 million in 1965 to about $66.7 billion at the end of 1978, of which $53.3 billion was held outside of savings and loan associations.

It is clear that our financial markets are in a state of flux. Change is everywhere, but it is uneven, uncontrolled, and uncoordinated with the kind of changes in the investment powers of thrift institutions that are necessary to their financial health.

The President stated that he would ask the Congress to—

Provide an orderly transition period during which all deposit interest rates will be permitted to rise to market-rate levels. This phase-out will be subject to emergency action by regulators if the safety and soundness of financial institutions is threatened or the implementation of monetary policy so requires;

Permit all federally chartered savings institutions to invest up to 10 percent of their assets in consumer loans; and

Permit all federally chartered or insured depository institutions to offer interest-bearing transaction accounts to individuals.

In addition, the President stated that he would ask Congress to direct the grant of authority for all federally chartered savings institutions to offer variable rate mortgages. At the time, only federally chartered savings and loans in California were authorized to do so. Since that time, the Federal Home Loan Bank Board has amended its regulations to grant such authority nationwide.

I would like to discuss the administration's proposals in more detail.

Deposit rate ceilings

The transition to market-level interest rates requires the balancing of multiple interests. Depositors prefer the expeditious removal of the ceilings, particularly while interest rates are high. Yet it is just at that time that the impact on banks and savings institutions of any change is the most severe. For example, it is estimated that the 25-basis-point increase in the passbook rate and the new 4-year floating ceiling certificates authorized by the regulators a few weeks ago will significantly reduce the earnings-to-

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assets ratio of savings and loan associations and mutual savings banks. Depository institutions must have time to adjust to the increased cost of deposits.

In order to balance the interests of housing finance, depository institutions, and depositors, the Congress should fix a minimum timetable for the phasing out of the ceilings. In addition, it should direct the regulators with rate-setting authority to bring deposit interest rate ceilings into line with market rates as promptly as is practicable and consistent with the safety and soundness of depository institutions and the implementation of monetary policy.

Action of regulators.—The regulators should report to the Congress each year on their progress in bringing ceilings into line with market rates and the impact of the changes on the safety and soundness of depository institutions, monetary policy and the interests of depositors. More rapid change than is required by the minimum progress discussed below can be accomplished through the raising of ceilings on existing instruments or the authorization of new instruments with higher fixed ceilings or with floating ceilings.

Minimum progress.—Subject to emergency action described below, the law should require the ceilings to be increased a minimum fixed amount each year. We think the system adopted by S. 1347 is a good one: there would be no required changes for the first 2 years after enactment. That delay recognizes the impact on earnings of the high current rates embodied in the money market certificate and the recent action of the regulators in raising certain ceilings effective July 1 of this year. During the 2-year period, savings institutions will have an opportunity to implement their new asset powers. The regulators would be free to fix any ceiling for a deposit instrument so long as the ceiling is no lower than the applicable fixed rate ceiling for banks. After the 2 years, those ceilings, which are set forth below, would increase by 25 basis points on January 1 and July 1 of each year:

Bank ceilings effective July 1, 1979

	Ceiling (percent)
Passbook	5.25
Certificates (maturity):	
Less than 90 days	5.25
90 days or more but less than 1 year	5.50
1 year or more but less than 30 months	6.00
30 months or more but less than 4 years	6.50
4 years or more but less than 6 years	7.25
6 years or more but less than 8 years	7.50
8 years or more	7.75

We agree with the approach of S. 1347 in giving the regulators residual power to reimpose ceilings if monetary conditions or the safety and soundness of depository institutions so dictate.

Delay of minimum progress.—We cannot predict with precision the final impact of the changes being proposed by the administration. A great deal depends upon the behavior of interest rates and the demand for housing, as well as the ability of savings institutions to capitalize on their new asset powers. Accordingly, it is important for the regulators to have emergency power to delay the effectiveness of the minimum ceiling increase for any maturity, type of institution or geographical area upon a finding that the safety or soundness of depository institutions would be endangered, or that the implementation of monetary policy requires a delay. This standard differs somewhat from the standard set forth in S. 1347. In addition, we suggest that the mechanism governing the regulators' power to delay increases, as set forth in S. 1347, is too limited. We would be pleased to work with the subcommittee staff to develop an alternative mechanism.

Differential.—Public Law 94-200, which mandated the interest rate differential in favor of thrift institutions, will remain in place. Of course, as interest rates approach

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market rates, the significance of the differential will tend to decrease. By that time, savings institutions will have had sufficient time to implement their new powers.

These steps will increase the costs of depository institutions in times of high interest rates. For that reason, the phasing out of ceilings may exert upward pressure on mortgage interest rates, although mortgage rates would also tend to rise because of a mortgage credit crunch produced by disintermediation. Most important, however, the eventual removal of ceilings will remove the hand of Government regulation from this aspect of our credit markets. It will let the markets allocate as much credit to housing finance as that sector is prepared to bid for.

Interest-bearing transaction accounts

Like S. 1347, we urge the nationwide extension of NOW accounts for individuals and nonprofit organizations.

The introduction of NOW accounts will give to savings institutions throughout the country an important new tool in expanding the range of their services to consumers. It will give individuals the same benefit of interest on their checking accounts that many businesses now enjoy through efficient cash management.

This step will rationalize a bewildering array of interest-bearing transaction accounts and near-transaction accounts being offered by various kinds of institutions. Credit unions offer share draft accounts throughout the country, and the commercial bank regulators have authorized automatic transfer accounts nationwide. In New England and New York, NOW accounts are authorized for all depository institutions and are widely offered. The Federal Home Loan Bank Board has authorized federally chartered thrift institutions to make remote service units available to depositors. Now, the Court of Appeals for the District of Columbia has held that, except for State authorized services, many of these arrangements contravene the statutory prohibition against the payment of interest on demand deposits by commercial banks and against the offering of demand deposits by savings and loans and credit unions.

That decision is not effective until January 1, 1980. When it becomes effective, it will adversely impact more than 750,000 bank customers, 1 million credit union members and many depositors at about 200 savings and loan associations.

If the Congress does not act, this hodgepodge will not disappear. NOW accounts will still be available in New England and New York. There are also other arrangements that approach the payment of interest on transaction balances: Repurchase agreements for large business borrowers, and telephone transfer and telephone bill paying accounts for individuals. Moreover, money market funds and brokerage houses have begun to offer checking services, and credit cards have increasingly come to play a major role in the payments system.

While the period following the introduction of NOW accounts in Massachusetts was costly for depository institutions due to competition, subsequent experience in that state and elsewhere in New England has not resulted in a serious financial burden on the offering institutions. Nor have the competitive relationships between commercial banks and thrift institutions been markedly altered. The experience in New England and, more recently, in New York, will provide a model for the effective pricing and administration of these accounts.

We propose that, 6 months after enactment, all federally chartered or insured institutions be authorized to offer NOW accounts (share drafts in the case of credit unions). If necessary, the effectiveness of the Court of Appeals decision should be further delayed after January 1, 1980, by legislation to accommodate that transition period.

The accounts initially should carry an interest rate ceiling at the passbook rate for commercial banks with no differential for savings institutions, and the ceiling should rise on the same timetable as that applicable to the passbook rate. The regulators should have authority to accelerate or restrain these interest rate changes in the same manner as for all other deposit instruments. We no longer think—as we did in 1977—that there is a need to begin the NOW account rate below the passbook rate as part of a phase-in process. The phase-in period for commercial banks will have been accomplished by the process of accommodation to the automatic transfer regulations.

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And the 6-month transition should give thrift institutions an adequate opportunity to prepare for this new power.

Thereafter, the regulators should be free to change the deposit rate ceiling for NOW accounts independently of the ceilings for passbooks. NOW accounts serve a quite different function than passbooks and have a different significance for monetary policy. It may be desirable to establish a mechanism for fixing a uniform ceiling. The Congress may want to consider the arrangement embodied in S. 1664 that the four regulators with rate-setting authority fix the ceiling by majority vote. In the event of a tie, the Federal Reserve could cast the deciding vote.

The introduction of NOW accounts involves an expense for depository institutions that will coincide with the cost of phasing out deposit rate ceilings. To ease the introduction expense, we would restrict NOW accounts to individuals and nonprofit organizations. Since businesses are the major demand account holders, this approach should substantially ease the transition to these new accounts.

All depository institutions should be subject to reserve requirements on NOW accounts fixed by the Federal Reserve with a view to competitive equality and sound management of monetary policy. In principle, NOW accounts should be treated as demand deposits for reserve purposes. Pending a broader resolution of the questions surrounding Federal Reserve membership, we would not object to nonmember institutions maintaining their reserves at a Federal home loan bank, the FDIC, or the National Credit Union Board, as the case may be, to preserve their regulatory relationships. Those regulators would, in turn, pass the reserves through to the Federal Reserve.

While these matters would be better dealt with in the context of a broader settlement of the Federal Reserve membership question, we do not think the NOW account legislation need be delayed if agreement cannot be reached on the membership issue. Many financial reforms will affect the cost of doing business for banks, and in our view this bill should not be held up for that reason.

Variable rate mortgages

Late last year, the Federal Home Loan Bank Board approved the nationwide use of graduated payment and reverse annuity mortgages and VRM's in States in which the ability of State-chartered institutions to offer VRM's creates an adverse competitive impact. At the end of May, the Bank Board authorized federally chartered thrift institutions throughout the country to offer variable rate mortgages (VRM's). These actions are consistent with the President's program. We expect that those States that do not permit their State-chartered depository institutions to offer VRM's will amend their laws accordingly.

The Bank Board has included in its VRM regulation a variety of consumer safeguards to protect the public in the use of these new instruments. Undoubtedly, additional changes will be necessary, and the regulators must be free to modify the regulations based on experience and subject to congressional oversight. The Congress should monitor the experience with VRM's closely. We would suggest that the Congress not freeze the terms of VRM's by statute. As VRM's become more popular and their use extends over a period of years, it will be easier to appraise their impact and the need for any further changes in the consumer protection or other features.

The interests of the lender and the borrower must be balanced. If the home buyer is not required to take a VRM in lieu of a standard mortgage, and if the interest rate changes and other terms of the instrument are fair, VRM's should be a valuable addition to the array of mortgage financing vehicles. The additional flexibility afforded the home buyer and the institutions should be beneficial to both sides.

Some observers object to VRM's because they shift some of the risk of interest rate movements from the lender to the borrower, arguing that the assumption of that risk is the basic function of the intermediary. But the regulatory framework prevents savings institutions from taking the steps that other long-term lenders employ to deal with sharply rising interest rates; in particular, they cannot offer much shorter maturities because of the requirement of level payments. The lender thus has no way to protect against the risk of interest rate movements. Unless savings institutions are to be substantially freed from the requirement that they invest primarily in mortgages, a

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way must be found to permit long-term mortgages to accommodate high-interest periods such as 1973-74 and 1978-79. We think VRM's are a partial answer.

Consumer credit

We also suggest that savings institutions be permitted to invest up to 10 percent of their assets in consumer loans. This authority will afford institutions that do not already have this power under State law another opportunity to increase the yield on their assets to help defray the higher cost of deposits. Commercial banks have been making consumer loans for a long time with favorable results. Investing 10 percent of their assets in consumer loans will improve thrift institution earnings and increase their cash flow.

The addition of consumer loan powers is important to thrift institutions in another respect. As the ceilings rise, they must be in a position to offer consumers a broader range of services in order to maintain their deposit base. Together with NOW accounts, consumer loans are an important element of that new bundle of services.

This new power carries its own problems. Consumer loans have greater yields than mortgages because of higher administrative costs and because they carry a greater risk. Thrift institutions will need some time to develop the experience to extend consumer credit successfully.

The 10 percent limitation on consumer loans maintains the basic tie to housing of the thrift industry. Accordingly, savings institutions will continue to devote the major portion of their assets to mortgage loans. They are likely to do so even without a legal requirement, since mortgage lending is the business they know best and have spent years developing.

Exhibit 14.—Statement of Secretary Miller, September 11, 1979, before the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, on the public debt limit

My purpose here today is to advise you of the need for an increase in the public debt limit, and to request an increase in the authority to issue long-term Treasury securities in the market. After discussing these specific debt management requirements, I would like to comment on the need to strengthen the process by which Congress establishes the debt limit.

Debt limit

With regard to the debt limit, the present temporary limit of $830 billion will expire at the end of September, and the debt limit will then revert to the permanent ceiling of $400 billion. Prompt enactment of legislation is necessary to permit the Treasury to borrow to refund maturing securities and to pay the Government's other legal obligations.

Our current estimates of the amounts of debt subject to limit at the end of each month through the fiscal year 1980 are shown in the attached table. According to the table, the debt subject to limit will increase to $883 billion at the end of September 1980, assuming a $15 billion cash balance on that date. This estimate is consistent with the budget estimates in the July 12 midsession review of the 1980 budget and later revisions. The usual $3 billion margin for contingencies would raise this amount to $886 billion. Thus, the present debt limit of $830 billion should be increased by $56 billion to meet our financing requirements in fiscal 1980.

The amount of the debt subject to limit approved by Congress in the May 1979 budget resolution is $887 billion for the fiscal year ending September 30, 1980. Yet, since the budget resolution does not have the force of law, it will be necessary for Congress to enact a new debt limit bill before the Treasury can borrow the funds needed to finance the programs approved by Congress last May.

Early next week, the Treasury will announce offerings of 2-year and 4-year notes to refund $5.9 billion of obligations which mature on September 30 and perhaps to raise new cash. These new offerings will be scheduled to occur on or about September 25

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and 26. Since September 30 is a Sunday the obligations maturing on September 30 cannot be paid off or refunded until Monday, October 1, at which time the present debt limit authority will have expired. Thus, without congressional action on legislation to raise the temporary debt limit by September 24, we will be forced to postpone the 2-year and 4-year note offerings as delivery of the securities on October 1 could not be assured. Failure to offer these securities as scheduled could be disruptive of the Government securities market and costly to the Treasury.

Investors as well as dealers in Government securities base their day-to-day investment and market strategies on the expectation that the Treasury will offer and issue the new securities on schedule. Delayed action by Congress on the debt limit, therefore, adds to market uncertainties, and any such additional risk to investors is generally reflected in lower bids in the Treasury's auctions and consequently in higher costs to the taxpayer. To avoid this needless increase in the interest costs of financing the public debt, I strongly urge that congressional action on the debt limit be completed as soon as possible.

I know that this committee has made every effort in the past to assure timely action by Congress on the debt limit. Yet, the record of the past 2 years has not been good. During this period debt limit legislation was considered by Congress four times. On three occasions action was not taken before the expiration date, and the Treasury was unable to borrow until the Congress acted 2 or 3 days later. Significant costs were incurred by the Treasury, and extraordinary measures were required to prevent the Government from going into default. The Treasury was required to suspend the sale of U.S. savings bonds, and people who depend upon social security checks and other Government payments suddenly realized that the Treasury simply cannot pay the Government's bills unless it is authorized to borrow the funds needed to finance the spending programs previously enacted by Congress.

You would agree, I trust, that it is essential that we do everything possible to restore the confidence of the American people in their government. Unfortunately, this objective has not been served by our recent experiences with debt limit legislation. Confidence in the management of the Government's finances was seriously undermined each time the debt limit was allowed to lapse and we must all work to avoid that outcome in this instance.

Bond authority

I would like to turn now to our need for an increase in the Treasury's authority to issue long-term securities in the market without regard to the 4-¼-percent statutory interest rate ceiling.

Under this administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. This policy has caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965, the average maturity of the privately held marketable debt was 5 years 9 months. By January 1976, it had declined to 2 years 5 months, because huge amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing large cash needs of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years 8 months currently.

Debt extension has been accomplished primarily through continued and enlarged offerings of long-term bonds in our mid-quarterly refundings as well as routine offerings of 15-year bonds in the first month of each quarter. These longer term security offerings have contributed to a more balanced maturity structure of the debt, which will facilitate efficient debt management in the future. Also, these offerings have complemented the administration's program to restrain inflation. By meeting some of the Government's new cash requirements in the bond market rather than the bill market, we have avoided adding to the liquidity of the economy at a time when excessive liquidity is being transmitted into increasing prices.

Congress has increased the Treasury's authority to issue long-term securities without regard to the 4¼ percent ceiling a number of times in recent years, and in the debt limit act of April 2, 1979, it was increased from $32 billion to the current level of $40 billion. To meet our requirements over the next 12 months, the limit should be

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increased to $55 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $15 billion increase in the bond authority would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1980.

Debt limit process

Mr. Chairman, I would now like to comment on the process by which the public debt limit is established.

It is well recognized that the present statutory debt limit is not an effective way for Congress to control the debt. In fact, the present debt limit process may actually divert public attention from the real issue—control over the Federal budget. The increase in the debt each year is simply the result of earlier decisions by Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional budget procedures and provided a more effective means of controlling the debt. That Act requires concurrent resolutions of Congress on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

Moreover, as I indicated earlier in my statement, the statutory limitation on the public debt occasionally has interfered with the efficient financings of the Federal Government and has actually resulted in increased costs to the taxpayer.

Accordingly, the public debt would be more effectively controlled and more efficiently managed by tying the debt limit to the new congressional budget process. I hope that we can work together to devise an acceptable way to do this. I understand that considerable progress has been made in recent months by members of Congress who have dedicated considerable time and effort to this purpose.

I applaud these efforts and I pledge my full support to secure enactment of this important reform in the management of our nation's finances.

Public debt subject to limitation, fiscal year 1980, based on budget receipts of $514 billion, budget outlays of $543 billion, unified budget deficit of $29 billion, off-budget outlays of $12 billion
[In billions of dollars]

	Operating cash balance	Public debt subject to limit	With $3 billion margin for contingencies
1979		Estimated	
Sept. 28	15	823	826
Oct. 31	15	833	836
Nov. 30	15	843	846
Dec. 31	15	844	847
1980			
Jan. 31	15	840	843
Feb. 29	15	855	858
Mar. 31	15	862	865
Apr. 30	15	861	864
May 30	15	876	879
June 30	15	860	863
July 31	15	869	872
Aug. 29	15	877	880
Sept. 30	15	883	886

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Economic Policy

Exhibit 15.—Remarks by Assistant Secretary Brill, October 26, 1978, before the 19th Annual Business Conference, St. John's University, New York, N.Y., on the long-term economic outlook

Your speakers this morning have worked out a fairly neat division of labor—neat at least from my point of view. Bill Freund is going to take the more hazardous chore—the near-term economic outlook. You'll know whether he is right or wrong in short order. I've got the safer job—the longer term outlook. It's safer in that few, if any of you, will remember a decade from now if what I say today turns out to be wrong. Of course, if I'm right, I'll remind you. Otherwise, my talk will sink into the oblivion most economic forecasts deserve.

Moreover, I'm not going to attempt even a conventional forecast of the 1980's. Given economists' poor track record in forecasting, short- or long-term, I would not want to dignify these musings on longer term prospects with the specious accuracy of point estimates for GNP growth, for inflation, or for unemployment. Rather, I would like to focus on a few of the major economic forces that will be conditioning the economic environment of the 1980's. Will they be working for or against us in achieving our objectives of a prosperous, noninflationary future?

Since I am by disposition a Pollyanna rather than a Cassandra, I will lead off and spend most of my time considering one of the forces that should be helping us support noninflationary growth—the demographic changes we can expect in the 1980's. But I will try to be evenhanded and discuss other elements in the future economic environment that may be less supportive of our objectives. It is as important to know the difficulties we will be facing as it is to know the favorable trends that will assist us in meeting our objectives.

There is no doubt that the maturing of the persons born during the baby boom of the late 1950's will exert a substantial influence on the economic outlook for the mid-1980's. The population bulge associated with the baby boom has now proceeded through the teenage years and is entering the 20 to 24 year age group. By 1985 most of this group will be over 25 years of age. Thus, we are on the threshold of an increase in the number and proportion of people in the 25 to 55 age bracket—the bracket frequently referred to as the "prime labor force" group—and almost at the end of the experience of getting those young people through their "difficult" age.

The past explosion in the absolute numbers of young people in the labor force—an increase between 1970 and 1977, for example, of six million persons—resulted in unemployment rates for these workers which were not only high, but which were growing relative to the unemployment rates of prime age males. The connection between this growth in the number of young people and their higher unemployment rates is not difficult to explain. Some government policies, for example, have inhibited wage adjustments that would have helped to absorb younger workers. Minimum wage requirements have not only kept pace with average wage rates, but coverage has been extended to many areas in which younger workers are concentrated. In addition, welfare payments and unemployment compensation benefits have increased relative to after-tax earnings levels.

Companies were also faced with other difficulties in absorbing a more youthful work force. In many cases younger workers, lacking experience, are simply not good substitutes for older, more experienced workers. Quite aside from the fact that companies find it difficult to adjust their wage structures because of either public policies or labor contracts, they simply cannot easily reorganize themselves to provide a higher proportion of entry-level jobs. But these are precisely the kinds of jobs needed to absorb an exceedingly youthful labor force. Even if such entry-level jobs could have been provided, many companies feared that they would simply have to change back after the decade or so it has taken for the boom to pass and the work force to mature.

The extent of the recent problem and the relief we will realize over the course of the next several years are evident from a few simple statistics. In 1960, workers aged 16 to 24 constituted 16.6 percent of the labor force. In 1978, they constituted 24.5 percent. By 1985, this proportion will drop to between 21 and 22 percent of the labor force. Of

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course, this forecast like any other is subject to a margin of error. The proportion can deviate somewhat depending upon what assumptions are made about trends in the participation rates for various population groups, particularly for women.

But no matter what assumptions one uses, several major changes stand out: (1) Women will constitute a significantly larger proportion of the labor force, increasing from their present proportion of 41 to 44 percent by 1985; (2) the ratio of the "prime age" workers to the total labor-force is going to increase significantly; and (3) the proportion of the labor force accounted for by young people and new entrants is going to decline significantly.

These expected demographic changes in the labor force composition should have beneficial consequences for our objectives of noninflationary growth. The beneficial effects will operate primarily through two channels: (1) By lowering the "noninflationary" full employment-unemployment rate; and (2) by increasing the rate of growth in labor productivity.

- Young workers, and other new entrants into the labor force, have little job-specific training or expertise.
- Young workers are still searching among potential careers.
- Young people tend to have poorer continuous working records because of intermittent schooling and in the case of females a desire to stop working in order to raise families.

The consequences of these facts are that women and youthful employees tend to have high turnover rates, higher unemployment rates, lower wages and generally work in low productivity employment.

The resultant higher unemployment rates have an additional danger in that they invite governmental policies designed to fight the unemployment, but which may have inflationary side effects: e.g., efforts to stimulate aggregate growth at too rapid a pace. Some of the policies involve costly training and public service employment programs.

However, by 1985, the favorable demographic changes which have been outlined are expected to reduce the "noninflationary unemployment rate" back down to its early post-war level of about 4.0 to 4.5 percent. The noninflationary rate, that is, the lowest level of unemployment which can be achieved consistent with relative price stability, is estimated to have peaked at about 5.5 percent in the 1975–76 period.

The other major factor associated with demographic changes that will reduce inflationary pressures relates to productivity.

I am sure most of you in the audience are aware of the recent dismal productivity performances of the U.S. economy, but perhaps you are not aware of the full extent of the deterioration in this vital economic statistic. During the first 20 years of our post-war history, 1948–68, output per hour in the private economy increased at an annual rate of 3.2 percent. During the most recent decade, 1968–78, productivity growth dropped in half, averaging only 1.6 percent per year.

Many factors determine the rate of growth of labor productivity. Among the most important are the age, experience, and training of the work force—what is frequently referred to as "labor quality." Although it is difficult to develop precise quantification of this component of the growth picture, probably one-fourth of the productivity slowdown during the past 10 years is attributable to the deterioration in labor quality, as both the absolute numbers and relative importance of new entrants into the labor force increased. The influence of this factor on productivity should abate in the future as the demographics change.

Moreover, the negative productivity aspects associated with increased labor force participation by women should also diminish. For as women become more firmly attached to the labor force and as social barriers are overcome, they can be expected to move into higher productivity, semiskilled, skilled, and professional occupations.

There is also a possibility that the reduction in the number of teenagers and young adults will have a significant favorable effect on crime, and this would improve productivity by minimizing the loss of output and the resources which must be devoted to crime prevention.

Another major cause of the decline in productivity growth has been the failure of growth in the productive capital stock to keep pace with the growth of the labor force. During the first two decades after World War II, the U.S. gross capital stock

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grew at an average annual rate of 3.6 percent. During the next 10-year period, 1968–78, it also grew at a 3.6-percent rate. However, some of the growth resulted from investment in pollution abatement facilities rather than from investment in new plant and machinery designed to increase capacity and worker productivity. When allowance is made for this fact, growth of the "productive" capital stock during the last decade slowed somewhat as compared to the earlier period, from a 3.6-percent annual rate to a rate of 3.4 percent.

At first blush, this relatively small slowdown hardly seems worth mentioning. But if one remembers that over the very same time frame the annual rate of growth of the labor force accelerated sharply, from 1.3 percent to 2.5 percent, the implications become clearer.

As a consequence of these disparate growth rates, the process of capital deepening slowed markedly. The rate of increase in the capital/labor ratio dropped from 2.2 percent during the 1948–68 period to 0.9 percent during the 1968–78 period. Of course, some of this slowing is a legacy of the 1973–75 recession, which severely depressed business investment. But some of it is due to more basic underlying economic factors that hinder business investment. The slowing of labor force growth in the future, and the increased recognition in public policy development of the need to encourage business investment, should enable capital formation per employee to improve and thus provide the needed capital to make labor more productive. Such prospective improvement will restore at least part of the recent sizable loss in labor productivity and will have beneficial implications for slowing the rise in labor costs and prices.

I wish I could end my talk with this somewhat optimistic prognosis for future trends in inflation but, as I warned at the outset, I must examine both sides of the coin. For, basically, underlying price trends depend upon two elements—labor costs and raw material or natural resource costs. Unfortunately, the outlook for raw materials availability and costs is not as encouraging.

In the current debate about the long-term availability of raw material resources, there are a variety of views. On the pessimistic side, is the simplistic view, often attributed to the Club of Rome, that growth is exponential while reserves of materials are finite. It is then a simple arithmetic calculation to show that exhaustion and complete world collapse are inevitable. Twentieth century malthusiasm! I've held to the view for a long time that this is the kind of nonsense one gets by letting computer system engineers muck around in economics.

A less pessimistic and, in my judgment, more realistic view, recognizes that there are various economic feedback mechanisms that link consumption to scarcity. Such a view generally relies upon the efficiency of the market mechanism. It holds that shortages, or even impending shortages, will generate rising prices, and that rising prices will act as a danger signal discouraging use of the scarce resource and stimulating technology to come up with alternatives.

It is frequently pointed out that the abundance of minerals in the continental crust of the earth is many times—often millions of times—greater than known reserves. Moreover, the law of conservation of mass insures that metals once extracted from the earth can be used over and over again.

Man has had success, historically, in dealing with lower quality, less easily accessible resources. Additional productive land can be created by swamp drainage, irrigation, forest clearing, etc., and yields per acre can be increased. Similarly, additional mineral resources can be discovered by investment in exploration, and by technological change which allows the mining of ores not previously usable. In short, technology can add to supplies of "fixed" resources.

While it must be recognized that the supply of natural resources is not fixed, it must also be recognized that expanding this supply can be costly. There will always be enough materials and energy to satisfy demand, but at a price. The difficulty is that the price could be great enough to impair economic welfare.

Certainly, we're beginning as a nation to appreciate it in the area of energy. This is probably the best example of the process, the problem, the difficulties, the time, and the cost of any solution. The post-war economic and social structure, as it has evolved in this country, has depended heavily on the ready availability and low cost of

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convenient sources of energy. The delights of our standard of living—suburbia, shopping malls, a plethora of motorized gadgets—are a function of cheap energy.

We are now learning the kinds of adjustments we will have to make to learn to live in an era of expensive energy. Whether the source of energy in the future remains oil, or whether we are successful in switching a significant share of our energy utilization to coal or some other alternative source, is important for many economic and political reasons. But it is not critical to the issue of cost, for the capital investment involved in such a conversion is expensive and has to be funded.

I have a blind faith that the interaction of economic necessity and the advance in scientific knowledge will produce solutions. The questions are when, and at what cost. Until the answers are clearer, our adjustment has to put emphasis on conservation—moderating the growth in demand while we permit the economic and scientific forces to work.

We are already seeing some progress. High prices and legislation enacted since 1973 have begun to yield substantial dividends. U.S. energy consumption has declined relative to real GNP. In 1973, 60.4 thousand Btu's were required per dollar of real GNP. This ratio dropped to 56.8 thousand in 1977, a 6-percent decline. Some of the causes of the decline are:

- More efficient autos: Legislation enacted in 1975 has required that autos become more efficient. As a result: Gasoline consumption is at least 5 percent below levels which might otherwise have occurred; gasoline consumption should decline absolutely after 1980 or 1981.
- More efficient use of energy in manufacturing: Calculations by Professor Jorgenson at Harvard indicate that industrial users have cut their use of energy by 16 percent since 1973. This is corroborated by: Fragmentary reports on the improvement in the chemical and petroleum industry; numerous reports by the Department of Commerce and DOE that industry has improved efficiency.
- The growth in electricity consumption has been below trend. Historically, electricity consumption increased at an average annual rate of 7.3 percent, about 3 percent faster than real GNP. However, this historical trend has broken since 1972.

I have dwelt on this one increasingly scarce resource at some length because it serves as a concentrated example of the problem and the solution. What is important for the subject of my dissertation this morning—the economic environment of the 1980's—is that the solution for problems such as these does involve higher prices. Thus, the urgency for improving productivity as an offset to other, unavoidable cost increases is clear—and we are addressing this issue—not only in the near-term by our review of government regulations and paperwork requirements which increase costs and decrease efficiency, but also in the longer term with our emphasis on incentives to capital formation.

Exhibit 16.—Testimony of Secretary Blumenthal, April 4, 1979, before the House Appropriations Subcommittee on Treasury, Postal Service and General Government, on the state of the economy and the prospects for the dollar at home and abroad

I appreciate this opportunity to discuss the current state of the economy and the prospects for the dollar at home and abroad.

As I pointed out when I appeared before the full Appropriations Committee earlier this year, the American economy is at a critical juncture. Since the deep recession of 1974–75, we have enjoyed an impressive recovery of employment and production. We have had less success in maintaining the value of our currency at home and abroad.

This imbalance in our achievements cannot persist. Either we shall right the balance ourselves by bringing inflation under orderly control, or events will reassert equilibrium for us, by bringing the economic recovery itself to a disorderly close. There is no doubt which alternative best serves the public interest.

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Recent economic developments

The events of recent months have made it even clearer that the program of fiscal and monetary restraint announced last January was the appropriate and necessary course. Recent economic statistics show that real growth in the fourth quarter of 1978 was almost 7 percent at an annual rate, much higher than anticipated in January, more than double our estimate of the economy's long-term growth potential, and well above the 5-percent average rate of real growth during the current expansion. Coming as it did in the fourth year of cyclical recovery, with only very narrow margins of unutilized skilled labor and industrial capacity remaining, this unexpected upsurge in real growth was reflected in a more rapid rise in costs and prices. In combination, real growth and inflation added up to more than a 15-percent annual rate of increase in gross national product at current prices—a rate exceeded only twice before in the current expansion.

The pace of economic activity has slowed somewhat in the early months of this year. Some of this slowing has reflected adverse weather, some has reflected a normal letup in consumer spending following the surge in buying in late 1978. At the same time, we have seen a scramble by businesses to rebuild inventories, to accelerate ordering as delivery times lengthen, to borrow more heavily to finance outlays. Worst of all, we have seen an acceleration in inflation. With worldwide demand for industrial materials quickening, with costs rising, with capacity limits being reached in some key industries, prices of some commodities are again rising at a double-digit rate.

The emergence of excess demand pressures after 4 years of cyclical expansion threatens to disrupt the orderly and generally well-balanced nature of the recovery.

The recent inflation record

The rate of advance in prices in recent months is running far above acceptable levels. Consumer prices rose 0.9 percent in January and 1.2 percent in February. Over the 2-month span, the index was up at an annual rate of about 13 percent. This compares with a 9-percent rise in 1978 and just under 7 percent during 1977.

In part, the recent bad news on the inflation front reflects special unfavorable developments in farm and food prices. Part of the sharp January rise in food prices was due to severe weather in the Midwest and strikes in California. Meat prices rose nearly 5 percent in February alone. Some of these and other special factors will not be present later in the year.

But acceleration has also been taking place across a broad range of other prices. Clearly, the recent acceleration is not all due to special factors.

The recent wholesale price statistics have been particularly disappointing. The price index for finished goods rose at a 15-percent annual rate in January and February, and at a 12½-percent annual rate with foods excluded. Farther down the production chain at the intermediate and crude materials levels, the rates of increase have been even faster. This has built up pressures which will push up retail prices for the next few months. With delivery times slowing and rates of capacity utilization relatively high, particularly in the materials producing sectors, demand pressures are clearly a major factor behind the recent deterioration in price performance.

Late last summer, there were some early warning signs that the economy was entering a zone of excess demand which could make the control of inflation an even more difficult task. Since then, I regret to say, the signs of excess demand are even more apparent. The index of crude nonfood materials prices is often used as a sensitive measure of demand pressures. It rose at more than 30 percent, annual rate, in the first 2 months of this year, on top of nearly a 20-percent annual advance in the final 3 months of 1978.

More bad price news is possible in the months to come. Hopefully, however, the policy actions already put in train will result in some moderation as the year progresses.

- Business firms will have used up a large part of the price increases that are allowable under the wage-price program and the program has been tightened so as to spread allowable price increases more evenly throughout the program year.

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- The steps taken to moderate the use of 6-month money market certificates should contribute to a gradual easing of activity in the homebuilding sector where demand and cost pressures have been intense.
- The most severe feedback effects on domestic prices from last year's depreciation of the dollar have already been felt, and the stabilization of the dollar since our November 1 actions will alleviate some of the pressure on domestic prices induced by a weakening dollar.

As these measures take hold and some of the special factors fade from the picture, the latest upsurge in inflation should begin to moderate. In addition, the policies of restraint already embarked upon—a reduced budget deficit and tighter monetary policy—will contribute to a gradual reduction of aggregate demand pressures. Real growth is expected to taper off during the course of the year. Indeed, some economists in the private sector are projecting an actual recession. We do not expect a recession, but we do expect—and the economy badly needs—some relief from excess demand.

The policy of restraint

While some abatement in inflation is expected, we have to recognize that significant and enduring abatement requires persistent application of restraint. There is no quick cure for an inflation that has been building for over a decade. And there are no easy ways out. Unless the growth of aggregate demand is reduced, demand-pull inflation will merge with cost-push, and inflation will accelerate even further.

Incomes policies such as the voluntary wage-price deceleration program can play an important part in containing inflationary pressures. But they can be effective only in the context of macroeconomic policies that limit growth in aggregate demand to our resource availability.

While the inflation rate will be coming down later this year, there is a real risk that the current temporary burst of inflation will greatly complicate our task. If the recent burst of inflation is built into current wage demands, the wage-price spiral will be ratcheted upwards another notch. Wage restraint in upcoming negotiations will be crucial if we are to achieve the progress toward lower rates of inflation that the situation demands.

Profits grew very rapidly in the fourth quarter after virtually no growth in the third quarter. But profits typically show large increases in periods of sharply rising activity. The Council on Wage and Price Stability is intensifying its monitoring efforts to insure business compliance with the standards of the price deceleration program.

The need for a strong and stable dollar

The dollar's value cannot be protected at home if it is weak abroad, and we cannot maintain its integrity abroad if it is shrinking at home. Last year, that maxim received a sharp and painful illustration. The acceleration in domestic inflation served to weaken the dollar on the foreign exchange markets, and this in turn raised the domestic price level even further as the cost of imported goods rose and provided an umbrella for domestic price increases.

The President moved forcefully on November 1 to put an end to this vicious cycle. He endorsed the imposition of greater monetary restraint domestically and arranged with Germany, Switzerland, and Japan a program of closely coordinated intervention in the foreign exchange markets. The United States has mobilized most of the $30 billion in foreign exchange resources being used to finance our share of this effort. These funds have been obtained partly through use of U.S. reserves and partly by borrowing, including the issuance of foreign currency denominated securities.

Conditions in the foreign exchange market have clearly improved since November 1. The severe and persistent disturbances which characterized the markets last fall have been overcome. From its low point on October 31, the dollar has recovered on a trade-weighted basis by about 10 percent. Against the DM, the Swiss franc, and the yen, the dollar has appreciated by 9 to 21 percent.

Uncertainties regarding oil supplies and prices are the principal source of concern in the foreign exchange market at this time. These uncertainties have created some nervousness as market participants attempt to assess the potential consequences for

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various currencies. While the dollar has been quite firm during this period of uncertainty, the continued longrun health of both our currency and our economy requires a clear, firm, and constructive energy policy.

The Treasury Department has recently concluded an investigation under section 232 of the Trade Expansion Act of 1962 to determine whether crude oil and products are entering the United States in such quantities or under such circumstances as to threaten to impair the national security.

In 1975, acting under the same section 232 authority, Treasury Secretary Simon found that at that time the Nation's dependence on imported oil was so great as to threaten to impair the national security. That conclusion is, unfortunately, even more valid today.

The Nation's dependence on imported oil has increased dramatically since the 1975 finding. At that time, 37 percent of the U.S. demand for oil was supplied from foreign sources. In 1978, oil imports accounted for 45 percent of oil consumed in the United States.

The rising level of oil imports adversely affects our balance of trade and our efforts to strengthen the dollar; in 1978, outflows of dollars for our oil imports amounted to $42 billion, $15 billion more than in 1975 and offsetting much of the rise in our exports of industrial and farm products.

Our growing reliance on oil imports has important consequences for the Nation's welfare. Recent developments in Iran have dramatized the consequences of this excessive dependence on foreign sources of petroleum.

The continuing threat to the national security which our investigation has identified requires that we take vigorous action at this time to reduce consumption and increase domestic production of oil and other sources of energy. To the extent feasible without seriously impairing other national objectives, we must encourage additional domestic production of oil and other sources of energy, and the efficient use of our energy supplies, by providing appropriate incentives and eliminating programs and regulations which inhibit the achievement of these important goals. The President will shortly be announcing additional steps this Nation must take to solve our energy problem. All of us must unite behind him in support of a program that will liberate our economy from the continuing threat to our economic welfare and security posed by our overdependence on foreign oil.

Exhibit 17.—Excerpt from remarks by Assistant Secretary Brill, April 19, 1979, before the Greater Baltimore Economic and Business Outlook Seminar, on the inflationary fallacies

And dismay it is, for the behavior of prices thus far this year is nothing short of dismaying. Inflation at a 13-percent annual rate—that's the average for January and February—is unacceptable. Continued for long, it would undo the significant economic progress of the past 2 years, 2 years of substantial economic growth, 2 years of record job creation, 2 years of major reduction in unemployment, 2 years in which Federal spending has been harnessed and the budget deficit reduced dramatically. We cannot, and I am sure we will not, allow these economic gains to be dissipated by inflation.

The question, then, is not whether we will curb inflation, but how: with what tools and at what pace. Let me immediately set out some boundaries within which this question can and should be addressed. That is, let us rule out the nonanswers.

I regard deliberately trying to cure inflation by recession as a nonanswer. First of all, it doesn't work. We've tried it, and the recession of 1974–75, the worst downturn this economy has suffered since the Great Depression of the thirties, didn't eradicate the inflation virus. True, it did bring inflation down out of the stratosphere, but it left a residue of underlying inflation at a rate still unacceptably high.

Second, whatever success the effort achieved in bringing inflation down from historic highs was at the tremendous social cost of nine million workers unemployed and over a quarter of industrial capacity idle. This doesn't strike me as a cost/benefit ratio so rewarding as to be worth trying again.

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The other nonanswer that we can rule out from the start is a program of mandatory controls. I'm still bemused by the conviction in so many circles that we are inexorably on the path to controls, a conviction so strong that I have almost given up arguing with those who express it. But let me try once again. First, we do not have the statutory authority to impose controls, and the fight to curb inflation would be lost the day a request was made for such authority. Second, the concept of controls is repugnant to the President and to his advisers. Third, no system of controls has done more than temporarily suppress inflation forces. If not supported by the appropriate macroeconomic policies of restraint, and long-term policies directed at reducing costs and improving productivity, controls just delude all of us—policymakers, businessmen, labor and consumers—into confusing suppression of symptoms with fundamental cure of the illness.

Exhibit 18.—Testimony of Secretary Blumenthal, May 23, 1979, before the Subcommittee on the Constitution of the Senate Committee on the Judiciary, on the proposed constitutional amendment requiring a balanced Federal budget

I am pleased to be here today to discuss with the Committee the proposed constitutional amendments requiring either a balanced Federal budget or restricting in some way the growth of Federal outlays.

So that there is no misunderstanding about the position of this administration toward inflation, fiscal responsibility, and the role of government versus the private sector, let me reiterate that this administration is unequivocally committed to bringing the Federal budget into balance, and to doing so as swiftly as economic prudence permits.

Firm and continued restraint on Federal spending is the central element in achieving this commitment.

Since President Carter has taken office, we have already made impressive progress in this direction. The Federal deficit has been reduced from $66 billion in fiscal year 1976 to a projected deficit of less than $30 billion in 1980, a reduction of more than half. During this same period, the share of our national income and output devoted to Federal spending has been reduced—from 22.6 percent in 1976 to 21.6 percent in the current fiscal year, and a further reduction is proposed for 1980 and subsequent years.

A policy of fiscal restraint, reduced growth in Federal outlays, and a shrinking Federal deficit is the appropriate and necessary budget policy for today's economic circumstances, when the economy is reaching its capacity limits and inflationary pressures are accelerating. But it is clearly not the appropriate policy for *all* economic circumstances. Indeed, the moderately stimulative policy pursued over the past several years enabled the economy to recover from the deepest recession since the 1930's and to put almost eight million Americans to work.

It is neither possible nor desirable to reduce the complex process of fiscal policy to the single constraint of budget balance. Flexibility is the necessary element of an effective fiscal strategy. Constitutionally mandating a balanced budget would undermine our efforts to develop and practice prudent economic policy.

Strict budget balance at all times, which is the mandate of most of the amendments proposed in recent months, has several major flaws.

First, the deficit varies with economic conditions that are neither wholly predictable nor wholly controllable. Congress can and does limit the aggregate level of spending. But it cannot control total receipts. While tax rates can be legislated in precise terms, taxable incomes can and do vary as total output, employment, and incomes fluctuate. Consequently, a budget that would be in balance at one level of output and income would be in deficit or surplus at other levels of economic activity. It is possible to aim fiscal policy at the objective of a balanced budget, but achieving this objective depends on a complex of factors that determines the economy's aggregate activity and income, a complex in which Federal spending and Federal tax rates are only partial influences.

This brings me to the second point: A rigid balanced budget mandate could exacerbate economic fluctuations. If income falls unexpectedly, then budget balance can be achieved only if tax rates are raised, or spending for the quarter of the total budget that can be controlled on an annual basis is drastically reduced. But such

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actions would be counterproductive because they would reduce output, employment, and incomes still further, resulting in bigger deficits which would, under a balanced budget mandate, require even larger cuts in spending and/or increases in tax rates. This is a formula for deepening recession, not for promoting economic stability.

This type of scenario cannot be dismissed as pure speculation. Although I am not overly enamored of the forecasting reliability of econometric models, I have somewhat more confidence in their ability to explain the past. Several econometric exercises show that if the Federal Government had been required to balance the budget during the 1973-75 recession, the economic consequences would have been far more severe than they actually were. A study by the Council of Economic Advisers, using three independent econometric models, showed that if there had been mandatory budget balance during the 1973-75 period, the unemployment rate would have risen to about 12 percent in 1975, compared with the actual rate of 8.5 percent. The number of unemployed would have increased to about 11 million during that year. Our real gross national product in 1975 would have been about 12 percent below the 1973 level. Rather than just a serious recession, the American economy would have suffered its first real depression since the 1930's.

The Federal budget can and has been used as a stabilizing tool when economic activity weakens. Annual budget balance, however, would eliminate this stabilization tool. In effect, a budget balance requirement would elevate that objective above other important goals such as high employment and healthy economic growth.

Moreover, a balanced budget amendment would need very complicated escape clauses for contingencies that cannot be foreseen.

The most obvious is that of war, which brings sudden and substantial increases in defense spending. If a balanced budget requirement were in place, either taxes would have to be raised, nondefense outlays reduced, or both. A large part of nondefense outlays—almost 90 percent—are uncontrollable, however, so that the compensating outlay reductions, which could be sizable, would have to come out of a limited number of programs.

In other conceivable contingencies, a balanced budget requirement would require severe and abrupt contractions in outlay programs. A natural disaster such as a major earthquake might require sizable legally mandated relief expenditures that would unbalance an otherwise balanced budget. If OPEC were to raise oil prices significantly, and this had a serious impact on the economy, fiscal policy could not be used to offset the impact of the probable outflow of dollars and purchasing power from the domestic economy. An extended coal strike, railroad or truck strike, or a widespread civil disorder could have similar depressing effects on the economy which would require unanticipated outlays that would unbalance the budget. In all of these circumstances, achieving budget balance would require prompt and sometimes sizable increases in taxes or large and destabilizing reductions in budget outlays not related to the emergency situation.

A budget amendment could conceivably be drafted that would contain sufficient exemptions and escape clauses to permit a budget to be out of balance. Indeed several of the amendments before this committee have such provisions. However, mandating budget balance as a provision of the Federal Constitution and yet providing the necessary flexibility for emergencies would require more literary and drafting precision than anyone has the right to expect, and might well trigger extensive litigation. And, in many cases, such an amendment would either be so complicated or such a sham that it would probably accomplish less than the President has already committed himself to accomplishing.

If budget balance is mandated, it would require very precise definition of those items of receipts and expenditures that are to be counted in achieving the balance. Items that are presently classified as a "means of financing" the deficit might be reclassified as a budget receipt in order to help balance the budget; for example, seigniorage, gold sales, and savings bonds sales.

In addition, mandating budget balance would create incentives to circumvent the budget as a control mechanism. Items could be moved off budget, as for example were the Postal Service and the Rural Telephone Bank, thus making the Federal budget less, rather than more, responsive to congressional control. Off-budget outlays rose rapidly in the mid-1970's, from half of 1 percent of the budget in fiscal 1974 to 2.4

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percent this year. The President's fiscal plans for fiscal 1980 and beyond reverse this trend toward increasing the number of off-budget Federal entities, but incentives to evade mandated budget balance could put us back on the path toward evasion of strict budget discipline.

Loan guarantees and insurance could replace direct loan programs so that the outlays do not affect directly the budget totals. This would be counter to the President's proposal for a new system to control the growth of Federal activities, particularly federally guaranteed credit.

In short, any constitutional amendment mandating budget balance would either be so filled with loopholes as to be meaningless or so rigid as to hamper the proper conduct of economic policy or national defense. Moreover, because precision of language and terminology are essential ingredients of an amendment to the Constitution, it is difficult to conceive of language that would be enduring and unchallenged over time.

In any event, the final arbiter of the content of the Federal budget could well become the Supreme Court. This would be a radical departure from our constitutional tradition which vests the executive and legislative branches with the full responsibility and authority for determining tax and expenditure policy.

The budget process established by the Congressional Budget Act of 1974 has made a major contribution toward bringing about comprehensive, logical, and responsible budgetmaking. It is a vehicle fully adequate for achieving budget balance when the Congress deems it the appropriate fiscal stance. This process, which is working well in bringing the total budget under control, would be short-circuited by a balanced budget amendment.

Constitutional amendments should be reserved for matters that cannot be dealt with by any other means. The budget can be balanced without a constitutional amendment. In fact, as I pointed out at the beginning of my statement, this administration is moving rapidly toward a balanced budget in a prudent and sensible manner that does not involve gimmickry and does not jeopardize the economic, social, or military goals of the Nation. I do not believe that all of these goals could be achieved if an administration were forced to abide by a constitutional amendment requiring mandatory budget balance every year.

Mr. Chairman, I do not question the sincerity of those who propose simple solutions to complicated problems, such as how to attain our national objectives of high employment, steady growth of output, stable prices, and a strong dollar. But in the words of President Kennedy some 17 years ago, "to attain them, we require not some automatic response but hard thought." Mandatory budget balance offers no escape from our responsibility for making better discretionary decisions concerning economic policies, including decisions on spending and taxes.

Enforcement and Operations

Exhibit 19.—Press release, October 12, 1978, entitled "Treasury Department Announces Changes in Procedures Concerning Firearms"

The Treasury Department and the Bureau of Alcohol, Tobacco and Firearms today announced changes in procedures governing routine compliance inspections of firearms, licensees, and investigations of gun shows.

Richard J. Davis, Assistant Secretary of the Treasury for Enforcement and Operations, and John G. Krogman, Acting Director of ATF, said that, except in a small number of situations, ATF employees will no longer make unannounced inspections of licensees. In most cases, licensees will be phoned the day before to notify them of the proposed inspection.

Inspections without prior notification will generally be limited to instances where there is reason to suspect violations based on a licensee's prior conduct or on specific information indicating that a licensee may not be in compliance.

There will also be a small number of random surprise inspections for purposes of compliance analyses to assess the impact of prenotification. According to Acting Director Krogman, "This policy will provide us with the flexibility to deal in as fair a

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manner as possible with the overwhelming number of dealers who honestly seek to obey the law, while still enabling us to move against those who may be sources of firearms for the criminal."

In another change, the ATF is limiting its investigations of gun shows and flea markets to those instances where there are specific allegations that significant violations have occurred or will occur and where there is reliable information that guns sold at the specific show or flea market have shown up in crimes of violence with some degree of regularity. "While serious violations of the law cannot be ignored," Davis said, "we believe that ATF must continue its efforts to concentrate its resources on those areas where illegal activity will have the most impact. This means that, except for exceptional cases, criminal enforcement personnel will not be involved in these kinds of shows. We do hope, however, that operators of these shows and markets will work with ATF's regulatory inspectors so that questions about procedures can be amicably resolved."

Davis said the Treasury Department and ATF intend to review the Bureau's operating procedures continually in an effort to improve its record of achievement and to ensure that it carries out its mission with the highest degree of professionalism possible.

Exhibit 20.—An Act to amend the Coinage Act of 1965 to change the size, weight, and design of the $1 coin, and for other purposes

[Public Law 95-447, 95th Congress, S. 3036, October 10, 1978]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Susan B. Anthony Dollar Coin Act of 1978. 31 U.S.C. 324b-1 note.

SECTION 1. This Act may be cited as the "Susan B. Anthony Dollar Coin Act of 1978".

SEC. 2. Section 101(c)(1) of the Coinage Act of 1965, as amended (31 U.S.C. 391(c)(1)), is amended by striking out "1.500" and inserting in lieu thereof "1.043" and by striking out "22.68" and inserting in lieu thereof "8.1".

Design. 31 U.S.C. 324b-1.

SEC. 3. The one-dollar coin authorized by section 101(c) of the Coinage Act of 1965, as amended by section 2, shall bear on the obverse side the likeness of Susan B. Anthony, and shall bear on the other side a design which is emblematic of the symbolic eagle of Apollo 11 landing on the moon.

SEC. 4. Section 203 of the Act of December 31, 1970 (31 U.S.C. 324b), is amended by striking out "initially" and by inserting "(d)" after "section 101".

31 U.S.C. 391 note.

SEC. 5. Until January 1, 1979, the Secretary of the Treasury may continue to mint and issue one-dollar coins authorized under section 101(c)(1) of the Coinage Act of 1965, as such section was in effect immediately prior to the date of enactment of this Act.

Exhibit 21.—An act to authorize the President of the United States to present on behalf of the Congress a specially struck gold medal to Lieutenant General Ira C. Eaker, United States Air Force (retired)

[Public Law 95-438, 95th Congress, S. 425, October 10, 1978]

Lt. Gen. Ira C. Eaker. Medal.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the President of the United States is hereby authorized to present, on behalf of the Congress, to Lieutenant General Ira C. Eaker, United States Air Force (retired), a gold medal of appropriate design in recognition of his distinguished career as an aviation pioneer and

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Air Force leader. For such purpose, the Secretary of the Treasury is authorized and directed to cause to be struck a gold medal with suitable emblems, devices, and inscriptions to be determined by the Secretary of the Air Force with the approval of the Secretary of the Treasury. There are authorized to be appropriated not to exceed $5,000 to carry out the provisions of this subsection.

Appropriation authorization.

Duplicates.

(b) The Secretary of the Treasury may cause duplicates in bronze of such medal to be struck and sold at not less than the estimated cost of manufacture, including labor, materials, dies, use of machinery, and overhead expenses, plus 25 per centum of such cost of manufacture. The appropriation then current and chargeable for the cost of manufacture of such duplicate medals shall be fully reimbursed from the payment required by this section and received by the Secretary: *Provided,* That any money received in excess of the actual cost of manufacture of such duplicate medals shall from time to time be covered into the Treasury. Security satisfactory to the Director of the Mint shall be furnished to fully indemnify the United States for the payment required by this section.

(c) The medals provided for in this section are national medals for the purpose of section 3551 of the Revised Statutes (31 U.S.C. 368).

Exhibit 22.—Excerpts from remarks by Under Secretary Anderson, October 18, 1978, to the National Bankers Association, 51st annual convention, Los Angeles, Calif., on the minority bank deposit program.

* * * * * * *

I am glad to be here because the Carter administration heartily endorses and strongly supports the minority bank deposit program. All of us will continue to work hard to make this program more meaningful for you and for our country. It is an important part of our broader effort to foster the full participation of all Americans in our free enterprise system. The Executive order on which the minority bank program is based rightly states that full participation by "socially and economically disadvantaged persons is *essential* if we are to obtain social and economic justice ... and improve the functioning of our national economy."

Let me assure you that a good deal of groundwork has been laid this year for increasing the level of Federal deposits in minority banks and for assisting you in the areas of management, training and capitalization. I will review for you some of the work that Treasury has been doing on your behalf.

The President, as you know, met with members of the minority banking community in the White House in April 1977 and reiterated his support of the Federal effort to aid minority business enterprise. He reaffirmed a goal of $100 million in Federal deposits in minority banks by the end of 1977. On December 31, 1977, approximately $127 million of Federally controlled funds was on deposit with minority banks. The level of deposits and the number of banks participating in the program have continued to grow. In that respect, we believe the program has demonstrated some success. As of June 30, 1978, the level of deposits had reached approximately $145 million. The number of banks has grown from 31 in 1970 to 97.

Now when I speak of "level of deposits," I refer to those Federal monies which remain in minority banks for more than 24 hours. Some of that $145 million—about 19 percent—represents investment funds. The remainder is composed of grant, contract, and Federally controlled time and demand accounts. Treasury tax and loan account balances amounted, as of June 30, 1978, to an additional $145 million average daily balance. Flowing through Treasury general accounts are deposits such as those of the IRS and Customs which provide approximately $500 million on a monthly basis in minority banks. As you can recognize, then, there is more than $145 million Federal money flowing through minority banks on a daily basis.

Most of you know that Secretary Blumenthal established a Treasury Policy Review Committee on Minority Banks. That committee received recommendations last fall from NBA and held a number of meetings with various Federal agencies. One of the

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issues before that committee was the effect of the cash management guidelines upon the minority bank deposit program.

As taxpayers, I know you all favor reducing the cost of government. That, of course, involves adherence to good cash management principles. Treasury, nevertheless, has been seeking creative ways to assure that your banks will continue to receive ever-increasing levels of Federal deposits. As you probably know, both OMB and the General Accounting Office, an arm of the Congress, scrutinize very carefully the costs of all services to the government—including banking costs.

Under Fiscal Assistant Secretary Paul Taylor's guidance, the Treasury Banking Staff works daily to alleviate some of the problems you have experienced in handling Federal deposits, particularly problems related to deposits which flow through Treasury general accounts. Despite what may appear to be obstacles raised by the cash management principles, Treasury has worked out methods whereby, as of June 30, 33 minority banks were servicing Treasury general accounts and several more have been added since. Arrangements have been worked out whereby correspondent bank relationships are utilized to the maximum in order to permit minority banks to handle Treasury deposits they would not otherwise be able to manage.

I believe we should continue to stretch our imaginations to help you deal with problems even before they arise.

After the Policy Review Committee submitted its recommendations to Secretary Blumenthal, and he approved them, Treasury forwarded those recommendations to the Interagency Council for implementation by all the agencies. As you know, the bank deposit program is not a Treasury program, but an administration program, carried out Government-wide by all agencies and monitored by Treasury for the Interagency Council and the Commerce Department.

One of the recommendations was that all agencies set goals for minority bank deposits. I speak in terms of "goals," not "quotas." The President, after the *Bakke* decision which struck down quota-setting as unconstitutional, called upon Federal agencies to concentrate more effort on affirmative action programs. The minority bank deposit program is an affirmative action program, and Treasury intends to follow the President's mandate to make every effort to make the program more effective.

Treasury, meanwhile, has already begun to see the results of implementing the Policy Review Committee recommendations. One recommendation which has been carried out with much success was that Secretary Blumenthal write to Fortune 1300 to urge those large companies to wire transfer their tax deposits to minority banks as opposed to depositing checks drawn on nonminority banks. The Secretary noted in his letter to the companies that the bank-wire method of transferring funds greatly enhances the benefits derived from tax payments for the minority banks. Of the responses received thus far, 75 percent of the firms indicated that they are currently using minority banks and either are, or will consider, wire transferring their tax deposits.

We hope that all agency heads will follow this recommendation and contact individually the private sector firms with which their agencies deal. The private sector will respond. Just recently I referred a call from a large insurance company to NBA. The company wanted the names of some minority banks in which to deposit funds.

We are prepared to help you in marketing your services to Federal agencies. Many of you are already familiar with the booklets entitled "Information on Federal Agencies and Grantees by Geographic Area" which Treasury prepared for your use. These booklets identified Federal monies flowing into each bank's service area by agency and by grant recipient. Contact sources and marketing information on each of 24 Federal agencies were also included. These booklets were discussed and distributed to you at last year's convention in Houston. Mr. Gordon Studebaker, who prepared the booklets for Treasury, then visited a sampling of banks to determine if the booklets were being used.

Although some of the information may need to be updated by now, I do believe they contain a wealth of information that would be very valuable if you could take the time to study them. The booklets contain over 25,000 marketing leads in an amount close to $70 billion. I am sure that the Interagency Council staff, as well as the Treasury Banking staff, would be happy to discuss the booklets with you. Rita Howard, of Treasury's Banking Staff, is here today. She has worked closely with

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many of you, and I am sure she would very much appreciate any comments you may have about the utility of the marketing booklets. We need your feedback so we may be of help of you.

Treasury has also worked out a plan to soften the impact of the implementation of Public Law 95-147, which authorized the Treasury to invest its operating cash in obligations of depositaries maintaining Treasury tax and loan accounts. We have received congressional approval to place a special demand deposit with each bank participating in the Government's minority bank deposit program. We intend to place these balances at approximately the same time the investment authority is implemented—November 2. Most of you are aware that the implementation date was delayed because Treasury did not receive the necessary appropriation to pay the fees until the end of September. It is estimated that at least $36.2 million will be placed with the minority banks during the first year.

Most of you have already received notification from the Treasury of how the demand deposits will work. If you have any questions, I am sure that the members of the Banking Staff here at the convention will be happy to answer them.

* * * * * * *

While we are pleased with the progress that I have just outlined—and I hope you are—we are not totally satisfied and do not plan to rest on our laurels. One of Treasury's recommendations forwarded to the IAC was that OMB be requested to include on forms already required of grantees a question about their utilization of minority banks. This information would be invaluable in targeting your solicitation of business. The IAC staff is working with OMB now on that proposal. We continue to work closely with IAC and OMB to follow through on this recommendation.

The Secretary and the White House receive status reports on the program. They are monitoring it carefully. Some agencies are now in the process of working out methods which will fit their particular needs and which will allow them to utilize minority banks more readily. I know that some of you read about the placement of CETA funds by the Labor Department into minority banks. HEW is also working on plans to place more medicare funds in minority banks.

In the long run, however, there is only so much that Treasury and the Federal Government can do. Government funds are volatile, at best. Investment deposits and long-term deposit relationships are better sought in the private sector. That is why the Secretary has been encouraging large companies to seek out minority banks. * * *

I know and understand your frustrations. I share some of them. I was a banker for 27 years, and I am accustomed to making things move. With the help of all of you, and with the assistance of the newly formed IAC staff under the capable leadership of Bob Kemp at Commerce, with the support of Mr. Louis Martin at the White House, I believe we can come up with some solutions that can be measured not just in deposit levels, but in stability and prosperity for you, your banks and your community.

We need your feedback and suggestions, as I have said before. While we are eager to help you with your specific problems, we must rely upon you to tell us in practical ways what would help you most. We also need for you to have a realistic understanding of just what is involved in handling Government funds as opposed to private-sector funds. I am looking forward to building upon the groundwork already laid. It is a good foundation for real progress. We need your cooperation to make that progress.

Thank you again for the opportunity to be here. I will be happy to answer any questions you may have.

Exhibit 23.—An act authorizing the President of the United States to present a gold medal to the widow of Robert F. Kennedy

[Public Law 95-560, 95th Congress, H.R. 8389, November 1, 1978]

Mrs. Robert F. Kennedy. Gold medal presentation.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled; That the President is authorized to present, in the name of Congress, an appropriate gold

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medal to Mrs. Robert F. Kennedy, in recognition of the distinguished and dedicated service which her late husband gave to the Government and to the people of the United States. For such purposes, the Secretary of the Treasury shall cause to be struck a gold medal with suitable emblems, devices, and inscriptions to be determined by the Secretary. There is authorized to be appropriated the sum of $3,000 to carry out the provisions of this section.

authorization.

Appropriation authorization.

SEC. 2. The Secretary of the Treasury is authorized to strike and make available for sale to the public—

(1) full-sized duplicates in bronze, and

(2) replicas in bronze, one and five-sixteenth inches in diameter, of the medal authorized by section 1.

Exhibit 24.—Title IV, Public Law 95-630, November 10, 1978, cited as the "American Arts Gold Medallion Act"

SEC. 401. This title may be cited as the "American Arts Gold Medallion Act".

SEC. 402. The Secretary of the Treasury (hereinafter referred to as the "Secretary") shall, during each of the first five calendar years beginning after the date of enactment of this title, strike and sell to the general public, as provided by this title, gold medallions (hereinafter referred to as "medallions") containing, in the aggregate, not less than one million troy ounces of fine gold, and commemorating outstanding individuals in the American arts.

SEC. 403. (a) Medallions struck under authority of this title shall be minted in two sizes containing, respectively, one troy ounce and one-half troy ounce of fine gold. During the first year in which such medallions are struck, at least five hundred thousand troy ounces of fine gold shall be struck in each size of medallions authorized by this subsection. In succeeding years, the proportion of gold devoted to each size of medallions shall be determined by the Secretary on the basis of expected demand.

(b) Medallions struck under authority of this title shall be of such fineness that, of one thousand parts by weight, nine hundred shall be of fine gold and one hundred of alloy. Medallions shall not be struck from ingots which deviate from the standard of this subsection by more than one part per thousand.

(c) Medallions struck under the authority of this title shall bear such designs and inscriptions as the Secretary may approve subject to the following—

(1) during the first calendar year beginning after the date of enactment of this title, one ounce medallions shall be struck with a picture of Grant Wood on the obverse side and one-half ounce medallions shall be struck with a picture of Marian Anderson on the obverse side;

(2) during the second calendar year beginning after the date of enactment of this title, one ounce medallions shall be struck with a picture of Mark Twain on the obverse side and one-half ounce medallions shall be struck with a picture of Willa Cather on the obverse side;

(3) during the third calendar year beginning after the date of enactment of this title, one ounce medallions shall be struck with a picture of Louis Armstrong on the obverse side and one-half ounce medallions shall be struck with a picture of Frank Lloyd Wright on the obverse side;

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(4) during the fourth calendar year beginning after the date of enactment of this title, one ounce medallions shall be struck with a picture of Robert Frost on the obverse side and one-half ounce medallions shall be struck with a picture of Alexander Calder on the obverse side; and

(5) during the fifth calendar year beginning after the date of enactment of this title, one ounce medallions shall be struck with a picture of Helen Hayes on the obverse side and one-half ounce medallions shall be struck with a picture of John Steinbeck on the obverse side.

The reverse side of each medallion shall be of different design, shall be representative of the artistic achievements of the individual on the obverse side, and shall include the inscription "American Arts Commemorative Series".

SEC. 404. Dies for use in striking the medallions authorized by this title may be executed by the engraver, and the medallions struck by the Superintendent of coining department of the mint at Philadelphia, under such regulations as the Superintendent, with the approval of the Director of the Mint, may prescribe. In order to carry out this title, the Secretary may enter into contracts: *Provided,* That suitable precautions are maintained to secure against counterfeiting and against unauthorized issuance of medallions struck under authority of this title.

SEC. 405. For purposes of section 485 of title 18 of the United States Code, a coin of a denomination of higher than 5 cents shall be deemed to include any medallion struck under the authority of this title.

SEC. 406. (a) Medallions struck under authority of this title shall be sold to the general public at a competitive price equal to the free market value of the gold contained therein plus the cost of manufacture, including labor, materials, dies, use of machinery, and overhead expenses including marketing costs. In order to carry out the purposes of this section, the Secretary shall enter into such arrangements with the Administrator of General Services (hereinafter referred to as the "Administrator") as may be appropriate.

(b) The Administrator shall make such arrangements for the sale of medallions as will encourage broad public participation and will not preclude purchases of single pieces.

(c) The Administrator may, after consultation with the Secretary, issue rules and regulations to carry out this section.

SEC. 407. This title shall take effect on October 1, 1979.

Exhibit 25.—Remarks by Secretary Blumenthal, February 2, 1979, at the U.S. Assay Office, San Francisco, Calif. on the occasion of the minting of the first Anthony dollar coin at the San Francisco Assay Office

I'm pleased to join with members of this community today as we mint the first Susan B. Anthony dollar coin here in San Francisco.

I know many of you worked very hard for passage of the legislation which enables us to be here today. This is a significant event—not only are we introducing a coin which will be cost efficient to business and to government, but we are breaking an old government tradition—and believe me that is no easy feat.

In the past, most coins had a liberty figure obverse design. But for this new coin Congress has chosen to honor a real woman, one of the first suffragists, Susan B. Anthony, instead of a mythical figure. Isn't it refreshing to know that we have finally decided to move away from myths and toward reality? It's time we all realized that women have as much a right to be depicted on our coins as men, Indians, and even buffalos and eagles, time to realize that women be given the credit they deserve, and

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time to recognize them for their accomplishments. They should not merely be the obverse side of coins, of men, or of anything, but they must be fully recognized as persons in their own right. As Victor Hugo said, "There is one thing stronger than arms, and that is an idea when its time has come." Ms. Anthony—this is your time. We honor Susan B. Anthony on this dollar coin for all she has done for the struggle for human rights, and especially for her striving to help women gain the right to vote. It is particularly appropriate to do so at a time when our Nation has become so conscious of helping others with their quest for human rights.

It is time the United States portrayed a woman on a coin, for we are one of the few countries which until now had no real female likeness represented on any of our coinage. Perhaps that is why the dollar was in some trouble. When Susan used to crusade from town to town to advocate women's rights, she was backed by her father's money. Now we need Susan to back our money.

When President Carter signed the new coin act, he said, "This new coin will be a constant reminder of the continuing struggle for the equality of all Americans." It reminds me too of our constant struggle to stabilize the dollar. Susan Anthony, I sure hope you can help us now.

I'm not going to recite a litany of accomplishments and praises for the person we honor in this way. From what I understand about her, she wouldn't have wanted that. As she once said of President Roosevelt, "When will men do something besides extend congratulations? I would rather have President Roosevelt say a word to Congress in favor of amending the Constitution to give women the suffrage than to praise me endlessly."

In response to her wishes, I will not congratulate her, but will ask all those here today to join in a conscious effort to continue the fight for human rights—the fight she began so many years ago. If you all remember her motto, "Failure is Impossible," it will help provide us with the inspiration to proceed.

As for the new dollar coin itself, we anticipate much success. With your cooperation, that of retail firms, commercial banks, and the general public, it will soon become an effective medium of exchange.. It is smaller and lighter than the present Eisenhower coin and it will replace demand for one dollar bills. The Government will save 60 percent on the cost of minting dollar coins—this will amount to a savings of roughly $4.5 million a year—a fact of no small significance to an administration that is striving to balance its budget. With increased production generated by successful circulation, the savings will multiply.

The Anthony coin will be advantageous to private industry, including major retailers, banks, and transit companies, because of faster, easier handling of coins compared to notes. Also the automated merchandising industry will be able to offer a far wider range of products to consumers. Time will be saved at cash registers. It will be faster to count money both manually and automatically. Even a 20-percent displacement of notes by coins would permit Treasury to defer for at least the foreseeable future, a costly expansion program at the Bureau of Engraving and Printing.

In addition, the new design has an inner border providing a means for tactile recognition by the visually handicapped. The sandwich laminate of cupronickel makes the coin difficult to counterfeit or slug.

Susan Anthony was once described as having a "finely organized constitution and a good degree of compactness and power." I wish to describe our new dollar coin in the same way.

As to the concern that the new coin is inflationary, this simply is not the case. The increased use of higher value coins in this and other developed countries is the consequence rather than the cause of the general inflationary trend.

As the purchasing power of the lowest denomination rate declines, the highest value coin becomes a far more necessary component of a nation's coinage and currency system.

My feeling is that this coin could be one of the most valuable coins one can possess for it underlies a dual issue: this Nation's tremendous concern for human rights and with inflation. The intention is that we will succeed in extending the former and halting the latter.

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In closing, let me relate a piece of advice Susan Anthony received from an uncle. He said to her, "If you want to be a real success, you have to make the world notice you." She replied, "I'll make them stare." Little did she know that the whole world would one day be staring at her likeness on a one dollar coin.

Exhibit 26.—Press release, February 8, 1979, entitled "Treasury Calls for Educational Campaign on Drinking by Pregnant Women"

The Treasury Department today called for a broad educational campaign to alert the public to the risks of alcohol consumption by pregnant women.

Treasury said it would work with other Federal agencies, including the Food and Drug Administration and the National Institute on Alcoholism and Alcohol Abuse, the alcoholic beverage industry, and other interest groups to develop a program to raise the current level of awareness about this problem.

Richard Davis, Assistant Secretary of the Treasury for Enforcement and Operations, said: "Scientific evidence establishes clearly that the offspring of women who drink heavily during pregnancy could suffer mental and physical defects known as the fetal alcohol syndrome. Scientists disagree about the effects of moderate or binge drinking. But since we are unable to determine a safe level of drinking, it is important that the general public be made aware of the problem so they can exercise the proper cautions."

Treasury decided not to require a warning label on alcoholic beverage containers at this time since it wishes to avoid unnecessary government regulation and to give the private sector the opportunity to take appropriate action before imposing regulations. Treasury will take polls at the beginning of the campaign and after 6 months to a year to measure the success of the educational effort. If the campaign does not prove effective, Treasury said it would again consider requiring warning labels on alcoholic beverage containers. In addition, if ongoing scientific research provides more certain evidence of the adverse effects of lower levels of alcohol consumption, warning labels will be reconsidered.

Davis said: "There is reason to believe women will review their drinking habits during pregnancy if they are aware of the possible dangers. Under the current circumstances, we believe that a broadly based educational effort is the best means to provide them with the necessary information so that the birth defects that may result in some circumstances from drinking can be avoided."

The educational program is intended to include the distribution of a report on the effects of alcohol on the fetus, distribution of brochures to the public and to the medical profession, public service announcements on radio and television and educational programs in the schools. The program would be designed to inform women before they are pregnant or see a doctor and to educate men so that they can be supportive of any decision involving alcohol.

Treasury will meet with interested public and private organizations to plan specific elements of the program and to coordinate the overall effort. "We want to call forth the creativity and communications skills of the alcoholic beverage industry to inform people of this problem," Davis said.

Today's measures follow from a January 1978 announcement by Treasury that it would examine the effects of alcohol consumption on offspring and decide whether Government action was needed. Interested parties were asked to comment on the problem and whether it justified warning labels.

Treasury's Bureau of Alcohol, Tobacco and Firearms, which regulates the alcoholic beverage industry, received and analyzed more than 3,000 comments, including medical and scientific reports. Most of the comments (2,772) came from consumers. Most consumers, and industry groups, opposed warning labels, chiefly on the grounds that the problem affects a small percentage of women and that labels would be costly and ineffective. The medical profession was divided both on the effects of alcohol on pregnant women and the advisability of warning labels.

Because of the highly technical issues involved, Treasury adopted a recommendation by the President's Office of Science and Technology Policy that nongovernmental experts review the comments and related evidence.

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The experts were Dr. Sergio Fabro, a medical doctor with advanced degrees in biological chemistry and who is professor and director of the Fetal-Maternal Medicine Division, George Washington University Medical Center, Washington; Dr. Judith Hall, a medical doctor who is a specialist in genetics and Director of the division of Medical Genetics at Children's Orthopedic Hospital in Seattle, and Dr. Amitai Etzioni, a sociologist who is Director of the Center for Policy Research and currently a visiting fellow at the Brookings Institution.

Dr. Fabro reported that the "full blown" fetal alcohol syndrome—consisting of central nervous system dysfunctions, growth deficiencies, a cluster of facial abnormalities and variable other major and minor malfunctions—has been observed only in offspring of chronic alcoholic mothers. He also stated that while evidence indicates that with lower levels of alcohol consumption the full-blown syndrome is highly unlikely, some other poor pregnancy outcome (for example, low birth weight and still birth) appears possible. He said further study is needed to determine whether other than heavy drinking—for example, two to three glasses of wine with dinner or a martini before dinner—is harmful. He declined to offer an opinion on whether a warning label is justified.

Dr. Hall reported overwhelming evidence that the fetal alcohol syndrome exists where heavy drinking is involved and said it is probable that other more subtle deleterious effects occur in children whose mothers drink lesser amounts during pregnancy. She pointed to mental retardation as one such potential consequence. But, "this second type of the maternal fetal alcohol spectrum has not yet been fully evaluated or delineated." She recommended a warning label and a broad educational program.

Dr. Etzioni said that, in view of the present low level of understanding about the effects of alcohol on offspring, other methods of alerting the public might be more effective than a warning label. He said public policies with regard to warnings should vary depending on the strength of the data on the problem and the magnitude of the danger.

The experts reports are summarized in a Treasury progress report to be published in the Federal Register of February 9, 1979.

Previous Government actions to inform the public of the risks of drinking during pregnancy included the distribution by FDA, in coordination with NIAAA, of a bulletin on the fetal alcohol syndrome to a million health professionals. FDA has also reprinted and distributed an article on the subject for consumers.

Exhibit 27.—Press release, February 26, 1979, entitled "Treasury Department Withdraws Proposed Firearms Regulations"

The Treasury Department today said it is withdrawing various proposed firearms regulations published in the Federal Register on March 21, 1978.

These regulations would have required unique serial numbers stamped on every firearm by manufacturers, and quarterly reports to the Bureau of Alcohol, Tobacco and Firearms on all sales or other dispositions of firearms between licensed manufacturers, importers and dealers. They would not have required reports of the names or addresses of private citizens who purchase firearms.

These proposals, which generated the most comments from the public, will not be considered again in the foreseeable future.

ATF will continue to review the other proposals being withdrawn and consider whether some or all should be proposed again in the same or modified form. These proposals include requirements that licensees report thefts of firearms, modifications in procedures for members of the Armed Forces bringing private firearms into the United States and adjustments in procedures for transporting National Firearms Act firearms, telephone reporting by licensees of firearms transactions, and provisions to reduce the paperwork involved when returning firearms for repair or replacement.

Last year Congress voted to prohibit the use of appropriated funds to implement these regulations.

Treasury Assistant Secretary Richard J. Davis announced the withdrawal of the regulations at an appearance today before the House Appropriations Subcommittee

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for Treasury, Postal Service and General Government. The announcement was filed today with the Federal Register.

During his testimony Mr. Davis also stated that the Justice Department has decided not to appeal a recent decision by the U.S. District Court in Washington that ATF had statutory authority to promulgate regulations providing for security requirements for licensed premises. The court ruled on the issue after the Treasury Department rejected a petition submitted by the National Council to Control Handguns (NCCH), and the NCCH then sued the Department. Under the court decision, ATF, which had previously stated it did not have authority to issue such a regulation, must now consider this issue on its merits. Consideration will be given to whether it should issue an Advanced Notice of Proposed Rulemaking on this subject to secure additional information, particularly as to the cost-benefit of such an approach, before determining whether to make any proposals in this subject area.

Assistant Secretary Davis said, at the hearing, that the Department wanted to give the newly appointed Director of ATF an opportunity to review all of these matters.

Exhibit 28.—Statement by Assistant Secretary Davis, March 6, 1979, before the board of directors meeting of the Wine Institute, Monterey, Calif., on the regulatory issues involving the wine industry

I appreciate the opportunity to be with you today in Monterey. With all the intense activities that take place in Washington—meetings, congressional hearings, the daily mini-crisis, and the like—people in positions like mine sometimes begin to develop the misconception, and there is no doubt that it is a misconception, that the country, or at least all within our particular responsibilities, will grind to a halt if we are not personally there at our desks monitoring all that goes on. As this so-called self-importance syndrome develops, a deadly disease if not diagnosed and understood, we lose sight sometimes, I am afraid, of the benefit to all in going out into the country, meeting with people, explaining our goals and ideas, and gaining a better appreciation of theirs.

It is with these thoughts in mind that I decided to accept your kind invitation to address this meeting of the Wine Institute's board of directors. It is my hope that in doing so I can provide you with a better idea of our perception of the regulatory issues involving the wine industry, and gain from you increased understanding of your concerns and your views on these matters. Such an exchange is, I believe, particularly important where the wine industry is concerned. I recognize that, having seen a period where your product was totally prohibited, you may view with particular concern even lesser and very different regulatory actions directed at your industry.

The past 12 months have certainly been active ones during which we all have been addressing a wide number of issues and problems. It has seen the Bureau of Alcohol, Tobacco and Firearms (ATF) lose its Director and, just recently, gain a new one; analyses and studies of ATF's responsibilities from a structural point of view, in both the regulatory and the enforcement areas; the final wine-labeling rules; consideration of the impact of alcohol consumption on the pregnant woman, and what to do about it; a new proposal for partial ingredient labeling; efforts to review and modernize, if appropriate, ATF rules governing both trade practices and advertising; and a review of the Federal Alcohol Administration Act itself. Interest and activity in many of these areas will continue in the future. It is my hope today to provide you with an overview of how we have dealt with some of these issues, and what our thoughts are about the future.

In an important sense, one of the most significant of recent events is the appointment of a new Director for the Bureau, Bob Dickerson. Mr. Dickerson brings to his new responsibilities long years of experience with the Customs Service, where he served most recently as Deputy Commissioner. The experience he gained there as a manager responsible for activities with important commercial aspects will stand him in good stead as Director of ATF, particularly as he has the assistance of people of the high caliber of Steve Higgins, the Assistant Director for Regulatory Enforcement, who is with me here today.

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Initially, I would like to share with you some of the general ideas that permeate much of what we do.

First is our belief that there are two core aspects of ATF's responsibilities under the FAA Act: Those that involve assuring that competition within the industry is fair and open; and those that assure that consumers of alcoholic beverages receive appropriate, accurate, and nonmisleading information about the products they are purchasing. Each of these responsibilities has received and will receive full attention by the Bureau.

Second, in determining the appropriate way to implement these responsibilities it is important that we seek to avoid unnecessary burdens on industry. This involves two things: Trying to find the least expensive way to accomplish regulatory goals, and eliminating those regulatory requirements which no longer serve any useful purpose. The Bureau is, you should know, developing a formal system to help it identify regulations which fall into this latter category, and all its activities will seek to meet the former standard.

Third, regulatory requirements should be as simply and directly stated as possible so that both the regulated and the regulator know what is expected. Related to this is the need to assure that the industry, as well as consumers, in fact know what the rules are, and that significant concepts are not lost in informal rulings and advice. It is largely to work toward these goals—as well as to assure that the regulations involved are both necessary and responsive to modern business practices—that ATF has been conducting reviews under the Administrative Procedures Act of the advertising and trade practice regulations.

Fourth, it is our strong view that destructive competition among Government agencies is bad. I am sorry to report that in my years as a prosecutor I had occasion to observe the impact of this kind of competition first-hand. It is not beneficial to anyone; it wastes effort and resources; it causes investigations to be more difficult; and it causes a loss in necessary public confidence. So, too, with the regulatory world—destructive competition helps no one, not the regulated, not the consumer, and certainly not the Government agencies involved.

If destructive competition is bad, how are we to avoid it? As a general matter, we try to do so by coordinating our efforts with others with whom we share or have similar responsibilities. While uniformity of basic policy is generally desirable, this does not mean that ATF must simply follow the rules of other agencies such as the FTC or the FDA. In particular situations, differences in the alcoholic beverage industry may justify different results; in others the terms of the FAA Act may not justify requirements totally consistent with that decreed by other agencies under their statutory charters. It is important, however, that we work with these agencies so that the resulting overall system is as consistent and sensible as possible.

We recognize that issues relating to the role of the FDA and FTC in relation to that of ATF in regulating the alcoholic beverage industry are of particular concern to many of you. In the past these issues have at times emerged in the form of competitiveness among these agencies on particular matters, and proposals to assign some of ATF's responsibilities to these other agencies. As you know, last session, legislation was considered by the Congress which would have transferred much of ATF's labeling responsibilities to the FDA.

A source of this competition, and of some of these proposals, is a belief held by some that ATF has not given sufficient priority to its consumer responsibilities and that these responsibilities are inconsistent with some of its tax and other functions. I do not believe that these beliefs are soundly based. Nonetheless, these arguments are raised. And, it is fair to say that if we are to continue to argue that ATF, for example, should not lose its labeling responsibility to FDA, it is important that the Bureau have the ability and the interest to itself exercise those labeling responsibilities in a meaningful way that is fair to both consumer and industry alike. The Bureau, I believe, is trying to do this. This is certainly essential if these arguments for a continued ATF role are to be persuasive within both the executive branch and the Congress. And, at the same time ATF in working with other regulatory agencies has, I believe, gone a long way towards building the kind of constructive, noncompetitive relationship which can only benefit us all. Credit for this belongs not only to the Bureau but to these other agencies, particularly the FDA.

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This leads to two particular issues I would like briefly to raise with you—ingredient labeling and the problems associated with alcohol consumption during pregnancy. Comments about the recently published proposal for partial ingredient labeling are, of course, governed by the Administrative Procedure Act. I would like, however, to describe something about our approach to this issue.

I recognize that many of those present here have serious concerns about the ingredient-labeling issue and question the need for any proposal of this type. It is our view, however, that the notion of ingredient labeling is basically sound; providing consumers with information they desire to have so they can have a basis for selecting among products. A preliminary review of comments at recent hearings conducted by FDA, FTC, and the Agriculture Department appear to support this. Before issuing any final rule, however, these materials will be more completely analyzed.

At the same time, however, any regulatory proposal such as this must consider the costs involved for the industry and potentially the public. We have tried to do so. These proposals have been modified from those made earlier and depart in some respects from certain approaches generally followed in ingredient labeling. These include: Deletion of the order-of-predominance requirement; elimination of the sodium-level requirement; flexibility as to placement of the list on the bottle; allowance of shotgun labeling for essential components. In each of these instances, the principal motivating factor behind the change was a desire to reduce costs and adjust the proposals to reflect the realities of your industry.

We also discussed these proposals with the FDA. The result plainly was not a perfect one from their perspective. Nonetheless, they have supported it, believing as we do, that pending the receipt of comments, it reflects a reasonable balance between consumer and industry needs and concerns.

Over the next months we hope to receive comments from you on these proposals. Are there other steps that we can reasonably take that will reduce costs further or are sensible for other reasons? What will these proposals cost? These are some of the questions about which we are seeking information.

We are serious about this proposal. At the same time, let me assure you that we want your views and ideas. I cannot promise you that in the end we will agree on everything. I can promise that we will try to seriously deal with your concerns before coming to any final conclusions and that we will do a full regulatory analysis before deciding whether to issue any final rule in this area.

Another labeling issue we have recently been dealing with is the proposal advanced that we should place a label on alcoholic beverage containers warning people as to the risks of consumption for the pregnant woman. Dealing with this issue has been, and remains, difficult. It represents one of the most troublesome issues we have been facing as we struggle to understand better the nature of the medical evidence as well as how to communicate it. We are particularly concerned because we are not here talking about treating disease, we are talking about the potential to avoid the trauma and tragedy of birth defects. In attempting to determine the appropriate course of action we solicited public comment, retained medical experts as well as one on the value of labeling and other forms of education, and consulted with experts at the FDA, NIAAA, and the National Academy of Sciences.

Based on this analysis, we concluded that there was a plain need for public education about this problem to alert people to the risks of serious birth defects for the offspring of the heavy drinker during pregnancy and to the scientific uncertainty and differences—which our experts reported—as to the impact of lesser or binge drinking. In this instance we elected not, however, to simply turn to the labeling option.

It seemed to us that we should first try to work with industry, other private groups and other Federal agencies to mount a meaningful public education campaign, one involving media efforts, posters, and the dissemination of various materials to the public generally as well as to particular groups. We made this choice based on the uncertainties in the medical evidence and a belief that, if it can be done, public education may be preferable to what some may consider to be "just another Government warning." We intend to monitor this program as it develops and take polls to measure levels of public awareness about this issue. This will help us decide whether the course we have adopted is sufficient, or whether we must reconsider labeling or other action.

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I must confess that some have questioned the wisdom of looking first to voluntary cooperation in this situation. There are those who believe that we should have adopted a labeling proposal now. I do not doubt, however, that this nonregulatory approach can work. First, we have the support of others in the Government, and particularly of the FDA. This, I believe, reflects the positive relationship which has developed between the Bureau and FDA.

Most importantly, this program can work because the alcohol industry, and particularly the Wine Institute, does have a tradition of social responsibility. Given this attitude we are hopeful that together we can demonstrate the ability of Government and the private sector to work together without burdensome regulation to perform important and needed public service.

These then are the ways we look at some of the issues about which we share a common interest. I know that sometimes, we in Washington seem distant and nonresponsive. While various statutes—such as the Administrative Procedure Act—limit the amount of informal exchange we can have on some issues, I hope you will feel that we do desire as constructive a relationship as possible; that we do desire to be sure that decisions are made after full development of the facts; that we do desire that your needs and concerns are fully understood and not ignored; and that we do desire an ATF which carries out its responsibilities in a way that serves both you and the public at large well.

Exhibit 29.—Statement by Assistant Secretary Davis, March 30, 1979, before the Senate Committee on Governmental Affairs, on the Omnibus Antiterrorism Act of 1979 (S. 333)

I very much appreciate the opportunity to appear before this committee in order to discuss the explosives tagging provisions of S. 333, the Omnibus Antiterrorism Act of 1979. As you know, Mr. Chairman, in the 95th Congress we testified before other committees of both the House and the Senate concerning the Treasury Department's reasons for supporting the adoption of explosives tagging legislation; and recently we have again testified in the House in support of tagging legislation.

Today, I will present an overview of what the explosives tagging program is intended to accomplish, why Federal legislation is needed, what kind of legislation is most desirable, and what our answers are to criticisms of this program raised in other hearings. In addition to my remarks, Mr. G. Robert Dickerson, the Director of the Bureau of Alcohol, Tobacco and Firearms, will submit a detailed statement and supporting materials for the record.

As an attorney and former Federal prosecutor, my primary experience has involved dealing with how to investigate and prosecute crimes after they have been committed. But my responsibilities for the protective as well as the investigative enforcement activities of the Treasury Department demand a perspective which gives at least equal weight to the ability of government to prevent criminal activities, especially those employing violence.

Consequently, I have followed closely the development, under ATF and Aerospace auspices, of capabilities for introducing into nonmilitary explosives those unique elements—taggants—which would permit identification and detection of explosives. Very simply, the explosives tagging system would work as follows. Identification tagging involves the insertion of a number of tiny particles—the taggants—in an explosive material which would survive intact after an explosion and be recovered by bomb scene investigators. The identification taggant which is presently ready for commercial use involves several color-coded layers identifiable under a microscope. At the bomb scene, it would first be found in the debris through use of a long-wave ultra-violet light which causes the taggants to fluoresce. Since one side of most taggants will be magnetic, a magnet will be used to extract the taggants from the debris. The taggant itself would reveal the type of explosive involved, its manufacturer, and the date and shift when it was made. From this, the explosive could be traced through the distribution chain from manufacturers, to retailers and, in many instances, to the last, or a group of possible last, legal owners of the explosive.

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Detection taggants—which are microscopic capsules containing an inert material—would emit a vapor which could be detected by specially developed equipment and animals *before* the explosive containing them was detonated. The presence of bombs could, thus, be detected and lives and property saved.

These techniques, some of which could be implemented nationally in 1979 if we had the authority, offer law enforcement and security authorities an opportunity to use science and technology not only to solve more bombing crimes but also to prevent their occurrence. In this manner, a comprehensive explosives tagging program can significantly enhance the public safety.

The extent to which tagging will help counter bombing crimes will be largely influenced by how quickly and how many forms of explosives are tagged. It is very important, therefore, that as soon as technology allows, the requirement that a particular class of explosives be tagged should go into effect. One class of explosives—dynamites, water gels, and slurries—is ready for identification tagging now; black powder will be shortly. Tagging for the other types is expected to be ready at different times throughout the next 3 years. Following is a chart reflecting the status of development for tagging the various categories of explosives. It describes the dates we expect tagging could begin to be implemented if legislation is passed in this session and if sufficient taggants are then available. These estimates are those of ATF technical experts and the Aerospace Corp., the technical managers of this program.

IDENTIFICATION TAGGING

Black powder, June 1979
Smokeless powder, July 1981
Dynamites, water gels, and slurries, June 1979
Fuse and detonating cord, November 1979
Boosters, March 1980
Detonators, June 1981 (label method); October 1981 (double plug method)

DETECTION TAGGING

Black powder, October 1980
Smokeless powder, October 1980
Dynamites, water gels, and slurries, October 1980
Fuse and detonating cord, October 1980
Boosters, January 1981
Detonators, January 1981 (both single plug methods); June 1981 (label method); October 1981 (double plug method)
Detection taggant sensors, April 1981 through March 1982 (implementation of different devices)

Changes, both positive and negative, from the schedule projected last summer are due to various factors, including scientific developments, the lack of legislation, and delays in securing testing agreements with some manufacturers.

We urge that legislation be passed during this session which provides the Secretary with the necessary authority to require tagging of all types of nonmilitary explosives in order that we can minimize the delay in getting tagged explosives into the marketplace and maximize our ability to apprehend those who use bombs and to save the lives of their intended victims at the earliest possible time. Elimination of particular classes of explosives from this legislation will, we fear, provide a disincentive for the producers of those explosives to cooperate with the development and testing of tagging. The passage of comprehensive legislation, on the other hand, will provide a stimulus which would accelerate the process by which tagging of all explosives used in crimes could be accomplished.

The enactment of tagging legislation in a piecemeal fashion also will minimize and, likely, defeat the timely impact on bombing crimes which tagging might have. For example, if we were to achieve legislative authority that permits us to institute identification tagging for the dynamites, water gels, and slurries (which are ready for national identification tagging) but not for other explosives, we would not be able to respond rapidly to the expected shift from dynamites to other forms of explosives; and that shift will receive impetus because of these exclusions. Instead, we will have to: (1) continue to perfect tagging of those categories of explosives not ready today, (2)

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submit additional legislation to authorize the tagging requirement for those types, (3) go through additional sets of hearings to cover again the testimony already given on this, and (4) if the additional legislation then passes, wait for the taggant manufacturers and explosive manufacturers to gear up for production and use of the taggants in these other types of explosives. This will be a very lengthy process giving bombers years of immunity from the tagging of what are already commonly used explosives in bombs such as black and smokeless powders.

On the other hand, if we have a single, comprehensive bill—with the requirements that all taggants be safe, suitable, nondamaging. and available, and with the discretionary authority to make exemptions or delays when needed—the only step remaining once taggants for these other types of explosives are ready will be to institute the tagging requirement. This approach will not authorize the inclusion of taggants before it is safe to do so; tagging will happen only after tests, participated in by the manufacturers, have been completed successfully.

Passage of a comprehensive bill is also necessary so that the manufacturers of taggants and explosives will be prepared to invest willingly the resources needed to have production and distribution facilities ready. They will do so only if they know that there is a legal requirement for compliance and that the tagging requirement can be implemented on a certain date. This certainly can only be achieved through a comprehensive tagging bill.

The Department recognizes that some have urged that black and smokeless powders be excluded from this program because they are used lawfully by sportsmen. We cannot endorse such an exclusion. All explosives have both lawful and unlawful uses. Black and smokeless powders are not only used by the law-abiding; they are also used by the bombers. For example, among all bombings in 1978 recorded by ATF—including unidentifiables and incendiaries—black and smokeless powders were used in 18.5 percent of the total bombings. FBI figures for this period attribute 22.1 percent to the powders. A chart presenting a statistical analysis of the various explosives used in crime is attached to my testimony. Together, those powders comprise a tiny portion of the commercially available cap-sensitive explosives, yet their frequency of occurrence in bombings is several magnitude's greater than their proportional availability.

Given this situation, a program that excludes these powders will clearly have serious deficiencies. Initially, such an exclusion would encourage the increased use of powders in bombs. We are especially concerned about excluding powders from the detection tagging program. Given the relative frequency of their use in bombings, the use of taggant detectors would be of questionable value if they could not detect black and smokeless powder bombs. This exclusion would also reduce the cost benefits of identification tagging.

We have recently heard charges that the safety testing for identification-tagged dynamites, water gels, and slurries is not sufficient. That is not true. In our charge to Aerospace we have placed, and continue to place, the highest priority on the safety of taggants. Dynamites, water gels, and slurries tagged with the finally selected identification taggants have met every safety test. These tests were established and conducted by the explosives manufacturers themselves. Based on these tests, the manufacturers were confident enough to market their own tagged explosives. The explosives manufacturers have produced and sold seven million pounds of tagged explosives. These are undisputed facts attesting to the safety of identification taggants in this class of explosives. Further information supporting the safety testing is submitted as an exhibit to Mr. Dickerson's prepared statement. Safety tests are now being pursued on all other classes of explosives with participating manufacturers, and under our approach no tagging would be required until these tests have been passed.

From Treasury's perspective another vital issue for tagging has been whether the crimes solved and the deterrence established are worth the effort and costs of requiring the taggants. In order to assess this as objectively as possible, Management Science Associates was asked to study this question. While acknowledging the difficulty in assessing the impact of any program before it begins, the study concluded, and we believe, that the value and cost effectiveness of identification tagging is clear.

Identification tagging will not, of course, serve as an instantaneous means of finding bombers. We do not expect to solve crimes and obtain convictions on the basis of tagging evidence alone. Identification taggants will instead provide initial leads and

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Distribution of Explosives in Crime (1978)

	FBI			ATF		
	Number	Percent known	Percent w/unknown	Number	Percent known	Percent w/unknown
Incendiary	636	39.30	34.60	468	36.10	26.50
Black powder	196	12.10	10.70	171	13.20	9.70
Smokeless powder	209	13.00	11.40	157	12.10	8.80
Military	133	8.20	7.20	55	4.20	3.10
Dynamite	173	10.70	9.40	251	19.40	14.20
Other	271	16.70	14.70	194	15.00	11.00
Subtotals	1,618	100.00		1,296	100.00	
Unknown	219		12.00	471		26.70
Totals	1,837		100.00	1,767		100.00
Black and smokeless (shown as percentage of known)		25.10			25.30	
Black and smokeless (percentage including unknowns)			22.10			18.50
Black and smokeless (percentage excluding incendiaries and unknowns)		40.8			39.6	

supply an additional specific connection between the manufacturer of an explosive, the category of last legal purchasers of a particular lot, and other evidence found at a bomb scene such as package fragments, wires, clockworks. In addition, evidence extrinsic to the bomb scene such as employees with grievances against a bombed business can be compared with the list of purchasers of an identified lot of tagged explosives in order to reduce further the list of suspects. The additional speed with which taggants will help investigators make these initial links will provide an increased possibility of focusing on a class of suspects while the criminal among them is still likely to have some incriminating evidence in his possession.

The identification taggant is analogous to the date/shift code already required to be printed on high explosives. We know that date/shift data permits speedier traces and that ATF has analyzed those cases where date/shift code information has been retrieved from dynamite wrappers that survive explosions or were found before detonation. Their study shows that cases forwarded for prosecution where a date/shift code was found were nearly twice the number of cases without date/shift information. We expect at least a comparable result from the use of identification taggants.

Furthermore, this analogy should apply equally in terrorist bombings or bombings by professional criminals, where link analysis will be greatly enhanced through the taggants providing a clear means of showing connections and patterns common to several bombings even if perpetrated in several different parts of the country. Focus on the individual or group of extremists connected to multiple bombings will not only increase the likelihood of solution of several bombings through one overall investigation but will also save immense expenditures of manpower on bombings which might otherwise appear as unconnected events.

Detection tagging is, in a way, the part of the tagging program from which the greatest direct benefits to the public safety can be expected. With detection devices placed at high target value locations, we can go beyond solving bombing crimes only after the destruction has happened and begin, through predetonation discovery, to prevent bombings from occurring. The MSA study suggests that the cost-benefit of this form of tagging is less certain than that for identification tagging. Its analysis makes clear, however, that if one considers just the high risk, potential targets of catastrophic bombings—airports, planes, public buildings—then the benefits are clear. In addition, when one considers what detection tagging can do—save life and limb—the essentiality of going forward with this program becomes clearer.

While additional information on costs is contained in Mr. Dickerson's statement, I would like to note that the costs of tagged high explosives have been calculated at 2 cents per pound of tagged explosives. We do not believe this to be an unreasonable burden on either manufacturers or purchasers of explosives.

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We have also heard claims that complex and costly regulatory schemes will be initiated as part of the tagging program. Treasury and ATF have asked for no new recordkeeping legislation. Records are now required under existing laws, including those applicable to black and smokeless powders. The only additional requirement would be to show the taggant's code in existing records. This small additional bit of information could not possibly be a serious burden.

We also do not seek to tag those types of explosives seldom found in any bombings. We have no desire to impose burdens on commercial enterprises or private pursuits that do not have a clear public benefit. For example, we are not seeking to require the tagging of those smokeless powders inserted in commercially manufactured, fixed ammunition. Only powders for sale in bulk quantities should be tagged. We take this position because there is no measurable public benefit to achieve by tagging individual rounds of ammunition.

Furthermore, we will not require the tagging of blasting agents which are very rarely used in crimes. The greatest portion (80 percent) of the materials produced for use in commercial blasting is made up of blasting agents, the most common of which is a mixture of ammonium nitrate and fuel oil known as ANFO. The components of ANFO are not explosives until compounded at the blasting site. Then they nearly always require a booster and detonator in order to be exploded successfully. Both boosters and detonators are going to be tagged under this program since they nearly always occur in criminal use of high explosives. Thus, in the event that blasting agents are used in a particular crime, booster and detonation tagging will provide the tracing mechanism, and we will not have to undertake the massive and costly job of requiring that blasting agents themselves be tagged. Tagging of the boosters and detonators is cheaper, more readily applicable, and will have a much greater impact on bombings than tagging of the blasting agents.

The explosives tagging program is designed to help significantly in defeating the bomber, whether he is a terrorist or any other form of criminal. And because we believe in the overall value of tagging, we think that it would be appropriate, in addition to the specific safety and other protections which Mr. Dickerson and I describe in our statements, to have an obligation placed on Treasury and the Bureau of Alcohol, Tobacco and Firearms to report to Congress at least annually on the results of the tagging program. Such a report will enable Congress to continue to evaluate this program and, we believe, recognize its worth. We will be happy to work with the Committee in developing this and other proposals designed to assure the proper implementation of this program.

We recognize that many Americans have been touched by acts of terrorism and other bombing crimes. The victims—or their survivors—know that bombing is a particularly vicious and indiscriminate crime. It is a clearly deliberate act of violence in which the bomber has to acquire the knowledge of how to make a bomb; he has to fabricate the explosive device; and he has to plant it. This is a calculated, planned, and indisputable intentional process with severe consequences: death, injury and the destruction of property. For these reasons we believe that we should do all that we legitimately can to meet this problem.

Mr. Chairman, we have never offered tagging as a panacea to bombing crimes. It will not be. All bombings will not be stopped or prevented. In addition, we know that it will take time for the effectiveness of tagging to have an impact that gives a clear measure of its worth. We are confident, however, that identification tagging will help solve more bombings and that detection tagging will cause the discovery of more bombs before they detonate. Together, these two forms of tagging will meaningfully advance our ability to deal with the bombing problem and deter some criminals from using this deadly instrument. We believe that this is a contribution to the general welfare to which the American public is entitled.

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Exhibit 30.—Remarks by Under Secretary Anderson, May 8, 1979, before the NABW Western Pennsylvania Group and Bank Administration Institute, Pittsburgh, Pa., on law enforcement in the banking industry

I am very pleased to have this opportunity to participate in your program. As a career banker, I always look forward to visiting with my friends in the banking industry. I appreciate your invitation very much.

Tonight I would like to talk about a subject that should be of great interest to everyone in the banking field—law enforcement. You, of course, already know that Treasury enforces the banking laws and regulates national banks through the Comptroller of the Currency.

Most people associate Treasury with tax policy, economic policy, and international monetary affairs. It is sometimes forgotten that we have varied and complex enforcement responsibilities which have a direct impact upon your ability to do business in a relatively stable environment.

Oversight of the enforcement of the Bank Secrecy Act is one of my responsibilities. Treasury enforces the tax laws through the Internal Revenue Service. We protect the President, Vice President, visiting heads of state and certain other dignitaries. We also enforce gun control laws, investigate bombings, regulate the legal liquor industry (involving everything from labeling to trade practices) and attack the moonshiner problem. We enforce various economic embargoes and investigate smuggling and customs frauds. To do all this involves over 105,000 people, some 80,000 of whom are in the IRS.

It is a very difficult time to be in the law enforcement business. Past abuses, both real and imagined, have changed the atmosphere drastically in recent years. The complexity of our society and the resulting kinds of crimes committed nowadays require the cooperation of many agencies cutting across Federal, State, and local government responsibility. Government efforts amount to very little, however, without the support of the responsible business community, and that is why I would like to tell you about some of our activities which should be of interest to you. We need your support to make our enforcement efforts successful.

As I indicated earlier, oversight of the enforcement of the Bank Secrecy Act is one of my responsibilities. The purpose of the act is to enable law enforcement officers to overcome foreign bank secrecy laws which were, and still are, being used to frustrate investigations of tax evasion and other crimes. To ensure the success of our enforcement we must rely upon you.

As many of you are aware, the statute requires that—

- Banks and other financial institutions report unusual currency transactions in excess of $10,000 and maintain certain basic records;
- Travelers and others report the importation or exportation of currency and other bearer instruments in excess of $5,000; and
- All U.S. persons file reports concerning the ownership or control of foreign financial accounts.

For many years prior to 1969, when the act was introduced, Federal law enforcement agencies were well aware of the problems in prosecuting persons who use foreign transactions and foreign financial facilities to conceal or shield their violations of U.S. law. Some of the abuses of foreign bank accounts then included their use to hide income not reported for tax purposes; their use as a conduit to permit a U.S. depositor to "borrow" funds from himself and take a tax deduction for the "interest" the foreign bank charges him; and their use as a front in conducting securities transactions.

Of course, in some instances, the banking system was by-passed. Currency was simply packed in an attache case, carried out of the country, and deposited in a foreign bank. Congress recognized the problems facing law enforcement in attempting to collect evidence about these accounts and in October 1970, Public Law 91-508 was enacted. The Treasury implementing regulations became effective 2 years later.

Although the act gave Treasury extremely broad powers to require recordkeeping and reporting of financial transactions, the department has chosen a moderate course, striving to accomplish the goals of the statute without imposing unnecessary burdens.

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The regulations apply mainly to the banking and securities industries and set standards which reflect prevailing industry practices.

We believe that the regulations which are relatively uncomplicated have already helped fight white collar crime, political and commercial corruption, and organized crime.

The currency transaction reports have been valuable in many ways. The Treasury Department works closely with the Federal Drug Enforcement Agency and as a result helped to identify a widespread drug operation in the Miami area. All of the currency transaction reports are screened by the IRS. Also, they have been used by the Department of Justice and congressional subcommittees in connection with specific investigations.

The Customs Service, which is a Treasury agency, has had increasing success in utilizing currency transaction reports against drug dealers and other violators. For example, in one case—a joint investigation by Customs, the Drug Enforcement Administration, and foreign police—Customs seized 2,000 pounds of hashish, $19,000 in currency, and $130,000 in bank drafts. Further investigation disclosed other reporting violations and resulted in freezing more than $800,000 in various bank accounts. In December, three of the defendants were fined $500,000 each, the maximum amount possible under the Bank Secrecy Act, and given substantial jail terms.

Customs is also investigating with the Department of Justice possible violations of the reporting requirement by a number of large corporations in connection with the maintenance of slush funds. Customs makes several hundred seizures of currency and monetary instruments each year under a variety of circumstances. In one case last year, agents seized some currency that a traveler had concealed in his wooden leg.

Although we are pleased with the successes, we believe that we have only scratched the surface of the problem. Consider, for example, the huge amounts of money that flow through criminal enterprises. Legitimate businesses that gross far less have very high visibility in our communities. For example, in 1977, K-Mart Corporation required more than $1 billion in working capital to generate approximately $10 billion in sales. Yet, that is less than the estimated value of illegal drugs sold in the United States each year.

Can you imagine trying to conceal the cash generated from those operations? I can't. The fact that the criminals continue to generate and use large volumes of currency in their illegal activities is the reason that the Bank Secrecy Act is an opportunity and a real challenge to bankers to help discourage criminals from using cash. Although we had very broad authority to require in-depth reporting of currency transactions, Treasury decided to limit reporting to large, unusual transactions. The reasoning was that bankers are in the best position to know their customers and to decide what is normal activity in a customer's account. Therefore, you and your associates have a key role in our program to combat crime in America.

While Treasury is involved in catching criminals who abuse the banking system, smuggle, deal in illegal weapons, or make moonshine, we have as well substantive responsibilities aimed at the regulation of certain industries and protecting the public from Government abuse.

Recently, Treasury has taken several steps to assure that the public is more fully informed about the effects of consumption of alcohol by pregnant women upon the unborn fetus. There is much debate and some disagreement among the experts about the fetal alcohol syndrome, so we decided that we would refrain at this time from requiring the industry to place warning labels on alcoholic beverages. But we did prevail upon the industry to begin an education campaign utilizing all the modern techniques at their disposal to acquaint the public with the potential hazards of drinking while pregnant. We intend at the end of a year to assess industry efforts in this area. At that time we will determine whether additional information points toward advisability of warning labels.

Another consumer-oriented action which affects all of us is the recent proposal to require partial ingredient labeling on alcoholic beverages. These proposals have been designed to provide consumers with basic information while minimizing the costs for the producers. In addition, an updating of the wine labeling regulation was completed last summer.

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This is our "truth-in-labeling" approach to the expanding use of terms and descriptions which carry with them certain quality meanings and which, to the unwary consumer, may be misleading.

Most recently, the implementation of the Right to Financial Privacy Act of 1978 was begun by circulation of a Treasury directive which explained the major requirements of the act. I know that many of you are familiar with the act and, as with every new statute, are wondering what the ramifications are for you since it was directly aimed at financial institutions.

The purpose of the act, of course, is to prevent abuse of access to financial records by the Government and to assure that law enforcement agencies have access through proper channels when the information is needed for legitimate law enforcement purposes. Your responsibility as bankers will be to assure that, unless the customer has voluntarily authorized disclosure, the Government presents you proper authorization as required under the act. At the same time, once presented with the statutory certification of compliance by the agent, it is important that banks produce materials as required and not search for ways to avoid being cooperative. The statute clearly protects you from liability if you supply documents pursuant to the agent's certification that the terms of the statute have been met. Failure to recognize this can convert a statute which carefully balances privacy and law enforcement needs into one which virtually brings to a halt many legitimate investigations whose success will benefit us all.

While the process may seem cumbersome and a bother to some of us, in the long run, when the kinks are worked out and we are all more familiar with the mechanisms, I believe that we will be assured that the privacy of individuals is adequately protected, the institutions are informed as to their responsibilities, and the Government is supplied with information in an orderly and appropriate fashion.

Ultimately, we will all benefit from knowing precisely how to deal with confidential financial records.

You are certainly aware of the Secret Service role in counterfeit deterrance, and you know that the Treasury Department depends in large measure upon you and your institutions for assistance in our never-ending battle against criminals who would undermine our system of currency. In addition, you are often called upon to aid in the detection of forgeries on Government checks. We rely upon you private business people to alert us to irregularities. You have been entirely supportive.

I have every reason to believe that the banking industry will continue to help the Treasury Department make all these regulations and statutes work. I know that you have many questions about how these various provisions will affect you, in your business and in your personal lives. We intend to work more closely with other bank supervisory agencies to assure that you are kept fully informed. We will be happy to respond to inquiries.

We need your determination to make our law enforcement efforts a success. I am confident that the banking industry, as I know it, will make its concerns known, focus on the positive aspects of the regulations, and make constructive suggestions where needed. The Treasury Department depends upon you and your community.

We are looking forward to having your criticism and your cooperation. The Carter administration, as you know, is concerned about over-regulation and too much paperwork. I believe that upon examination you will find that the Treasury Department, in the enforcement area, has gone a long way to simplify requirements where possible.

The benefits of an ordered and stable society are readily apparent to all of us. I know that you are committed, as we are, to strong and effective law enforcement.

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Exhibit 31.—An act to authorize the President of the United States to present on behalf of the Congress a specially struck gold medal to John Wayne

[Public Law 96-15, 96th Congress, S. 631, May 26, 1979]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the President of the United States is authorized to present, on behalf of the Congress, to John Wayne, a gold medal of appropriate design in recognition of his distinguished career as an actor and his service to the Nation. For such purpose, the Secretary of the Treasury is authorized and directed to cause to be struck a gold medal with suitable emblems, devices, and inscriptions, including "John Wayne, American", to be determined by the Secretary of the Treasury. There are authorized to be appropriated not to exceed $15,000 to carry out the provisions of this subsection.

John Wayne. Commemorative medal.

Appropriation authorization.

(b) The Secretary of the Treasury may cause duplicates in bronze of such medal to be coined and sold under such regulations as he may prescribe, at a price sufficient to cover the cost thereof, including labor, materials, dies, use of machinery, overhead expenses, and the gold medal, and the appropriation used for carrying out the provisions of this subsection shall be reimbursed out of the proceeds of such sale.

Duplicates.

(c) The medals provided for in this Act are national medals for the purpose of section 3551 of the Revised Statutes (31 U.S.C. 368).

Exhibit 32.—An act to authorize the President of the United States to present on behalf of the Congress a specially struck gold medal to Ben Abruzzo, Maxie Anderson, and Larry Newman

[Public Law 96-20, 96th Congress, S. 348, June 13, 1979]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the President of the United States is hereby authorized to present, on behalf of the Congress, to Ben Abruzzo, Maxie Anderson, and Larry Newman, transatlantic balloonists, one gold medal each of appropriate design in recognition of their distinguished feat as aviation pioneers. For such purpose, the Secretary of the Treasury is authorized and directed to cause to be struck three gold medals with suitable emblems, devices, and inscriptions to be determined by the Administrator of the National Aeronautics and Space Administration with the concurrence of the Commission on Fine Arts, subject to the approval of the Secretary of the Treasury. There are authorized to be appropriated not to exceed $45,000 to carry out the provisions of this subsection.

Ben Abruzzo, Maxie Anderson, and Larry Newman. Commemorative medals.

Appropriation authorization.

(b) The Secretary of the Treasury may cause duplicates in bronze of such medal to be coined and sold under such regulations as he may prescribe, at a price sufficient to cover the cost thereof, including labor, materials, dies, use of machinery, overhead expenses, and the cost of the gold medals, and the appropriation used for carrying out the provisions of this subsection shall be reimbursed out of the proceeds of such sale.

Duplicates

(c) The medals provided for in this section are national medals for the purpose of section 3551 of the Revised Statutes (31 U.S.C. 368).

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Exhibit 33.—An act to authorize the President of the United States to present a gold medal to the widow of Hubert H. Humphrey

[Public Law 96-21, 96th Congress, S. 613, June 13, 1979]

Mrs. Hubert H. Humphrey. Commemorative medal.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the President is authorized to present in the name of Congress, an appropriate gold medal to Mrs. Hubert H. Humphrey, in recognition of the distinguished and dedicated service which her late husband gave to the Government and to the people of the United States. For such purposes, the Secretary of the Treasury shall cause to be struck a gold medal with suitable emblems, devices, and inscriptions to be determined by the Secretary. There are authorized to be appropriated not to exceed $15,000 to carry out the provisions of this subsection.

Appropriation authorization

Duplicates.

(b) The Secretary of the Treasury may cause duplicates in bronze of such medal to be coined and sold under such regulations as he may prescribe, at a price sufficient to cover the cost thereof, including labor, materials, dies, use of machinery, overhead expenses, and the cost of the gold medals, and the appropriation used for carrying out the provisions of this subsection shall be reimbursed out of the proceeds of such sale.

(c) The medals provided for in this section are national medals for the purpose of section 3551 of the Revised Statutes (31 U.S.C. 368).

Exhibit 34.—Statement by Under Secretary Anderson, June 14, 1979, before the Subcommittee on Government Information and Individual Rights, House Committee on Government Operations, on the proposed medical privacy legislation

Thank you for the invitation to testify here today on your proposed medical privacy legislation. Accompanying me is Mr. H. Stuart Knight who is the Director of the U.S. Secret Service. We endorse this legislation, particularly the disclosure exception for the U.S. Secret Service. We intend to focus our discussion on this exception as is provided in section 128 of your draft bill and why we feel such an exception is necessary for the Secret Service in order to carry out its protective functions. The administration has also submitted a medical privacy bill which contains a similar exemption for the Secret Service and we support the administration's position.

This is not a subject which the Department takes lightly. Individual right to privacy is a concept for which we personally have the highest respect. Medical records in particular often contain the most sensitive information about an individual. It is the kind of information which should have the highest possible level of protection and confidentiality. We endorse your bill in principle because it achieves just that.

Notwithstanding our views on the need for privacy of medical records, it is also our opinion that an outright exception to the prohibition to disclosure of medical records is absolutely necessary for the U.S. Secret Service. By the nature of its mission, the Secret Service must deal in terms of prevention. One of the many preventive measures taken by the Service is to maintain contact with mental institutions to remind them of the Service's existence and its interest in information which may reveal that an individual may pose a threat to a Secret Service protectee.

It is not our intention to infringe on the individual's rights to privacy. However, it is necessary to balance an individual's right to the privacy of his medical records with legitimate needs of the Secret Service for access to this type of information which under certain specific and limited circumstances is necessary in protecting the life of the President and other protectees. Section 128 of your bill would adequately deal with the Secret Service's need for this information.

I would like to take a few minutes now to address the reasons why Secret Service access to this type of personal information is so necessary to effectively carry out its protective mission. First, I would like to present some background information on the

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origin and legal basis for the Service's use of certain medical information in investigations connected with our protective functions.

Following the 1950 attack on President Harry S. Truman, Congress enacted Title 18, U.S.C., Section 3056, which gave the Secret Service complete statutory authority to protect the President, his immediate family, the President-elect and the Vice President. Congress has since expanded this authority to include the protection of additional protectees such as the Vice-President-elect, a former President and his wife, and visiting foreign heads of state.

After the assassination of President John F. Kennedy in 1963, the Warren Commission reported its findings and recommended an enlarged and more sophisticated protective operation for the Secret Service. The Warren Commission emphasized that the Secret Service should not limit its interest to persons communicating actual threats to the President, and stressed the importance of advance detection of potential threats against the President. The Commission also indicated that to require some manifestation of hostility against a government official was unduly restrictive as a criterion for furnishing information. Accordingly, the Commission recommended that the Secret Service broaden and formalize liaison with other agencies to obtain preventive intelligence. Based on this recommendation, Secret Service field officers were specifically directed to give greater emphasis to liaison with Federal, State and local law enforcement agencies, institutions for the mentally ill, and other potential sources of protective information. This was the origin of our present procedure.

In accomplishing this liaison, the Secret Service solicits from mental health institutions the voluntary identification of persons in their care who are characterized by any of the following categories:

(1) Has expressed an unusual interest in any protectee or category of protectees, which, in the opinion of the facility or health professional, could present problems affecting the safety of individuals within the protective jurisdiction of the Secret Service;

(2) Has threatened or assaulted local, State, or Federal government officials, excluding law enforcement officers; or

(3) May present, in the opinion of the facility or health professional, a possible danger to individuals within the protective jurisdiction of the Secret Service.

In addition, the Secret Service may, on occasion, seek information from a mental health institution on an individual who has already been identified by the Secret Service as being of continuing protective interest.

It is common belief that only those agents seen in close proximity to a protectee are effecting his/her protection. This is far from true. Protection involves concerted efforts in long-range advance planning and preparation. A basic element of protection is the early identification of possible sources of danger. The present Secret Service policy of maintaining liaison with mental health institutions is an operational application of this principle.

The Secret Service is interested in obtaining medical history information because historically the Service has found that the majority of persons who threaten and/or exhibit unusual interest in our protectees suffer from some form of mental illness. A review of Secret Service files indicates that at least 75 percent of the individuals of record with this Service, who have threatened and/or expressed an unusual interest in official persons and their families or installations of interest to this Service, have a known history of mental problems. Moreover, more than 90 percent of the individuals considered dangerous to protectees of this Service have a known history of mental problems. Thirty-three percent of these individuals considered dangerous are currently institutionalized in mental health facilities.

This statistical evidence explains the continuing interest of the Secret Service in individuals with mental problems. These individuals comprise the bulk of those subjects of serious protective interest to the Service.

The Secret Service depends on the expertise of the psychiatrist or hospital staff as to which individuals they feel they can or should bring to the Service's attention. The categories described above merely provide guidance to the health professionals in recognizing which persons may be of interest to the Service.

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Liaison with medical care facilities which treat the mentally disturbed is an essential means of identifying those individuals who, in the opinion of an institution's doctors or officials, may be of protective interest to the Secret Service. Information concerning an individual's mental health condition is acquired in two fundamental situations: one is through voluntary identification by a physician or institution as a result of routine liaison; the other is in response to a specific inquiry by the Secret Service where a particular individual has been identified as a possible threat to a protectee. Each Special Agent in Charge of a field office has the responsibility for ensuring that the proper officials in all hospitals and institutions treating the mentally ill understand the Service's interest.

The Service is dependent on the institution's doctors and officials for bringing possibly dangerous persons to its attention. It usually relies on their professional opinion in making this determination. The Service is only looking for information to assist it in determining the degree of danger an individual presents to a protectee. In most cases it is not necessary or even desirable to review a file if a doctor, hospital administrator, etc. will give a general idea of the individual's problem and an evaluation of his propensity for violence against a protectee.

The Secret Service is of the opinion that the procedure of maintaining liaison with hospitals and institutions for the mentally ill is vitally important to the overall preventive intelligence effort. Based on the statistical data previously cited, the Secret Service would be remiss if it did not concern itself with the potential threat to the President presented by this class of individuals. Secret Service efforts in this area are in accordance with the recommendations of the National Advisory Committee on Criminal Justice Standards and Goals. In 1976, this Committee published a lengthy study, titled "Disorders and Terrorism," from which the following is quoted:

> What, then, are the duties of the psychiatrist whose patient's fantasies of quasi-terroristic mass murder appear practical and possibly realizable? Or, to pose another example, what are the duties of the attorney to whom politically motivated terrorist clients divulge plans of future bombings? * * *
>
> The recommendations contained in this standard are far from being revolutionary in their content; general duties of confidentiality notwithstanding, codes of professional ethics recognize that under some circumstances, members of the helping professions are not only permitted but also obliged to notify law enforcement authorities of impending dangerous acts by clients, patients, and others. In some jurisdictions, special duties to report impending acts of violence that override the general duty to observe confidentiality have actually been imposed *by legislation or judicial action.*

As indicated in the above excerpt, on occasion it is necessary to disclose information which may be considered confidential by a patient and his psychiatrist in order to prevent the occurrence of an act of violence. This type of notification is especially important where the Secret Service protective function is concerned.

We recognize that when the Service receives this information it is for a very limited purpose. Therefore, all protective intelligence information received by the Secret Service is handled with the utmost discretion to protect the privacy of the individuals concerned. In particular, all information received as a result of Secret Service liaison with mental insitutions is handled with strictest confidence.

Protective intelligence files of the Secret Service are maintained and used by the Service only in its protective function. This is the only use of these files. They are not mingled with other files such as ordinary criminal histories. There is no access to these files by any other agency for criminal investigating or other purposes. They are not part of any multi-agency computer system and cannot be queried by either the National Crime Information Center (NCIC) of the FBI or Treasury's own Treasury Enforcement Communications System (TECS). Within the Secret Service itself, access is strictly controlled by personnel of the Intelligence Division of the Office of Protective Research.

These tight restrictions apply equally to the input of data into the files of the Secret Service. Input, like retrieval, is within the exclusive domain of the (Protective) Intelligence Division of the Secret Service.

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Only in certain life-threatening situations may intelligence information be disclosed to another law enforcement or governmental agency if it is felt that it may be of assistance. A situation of this type occurred on March 9, 1977, when 12 members of the Hanafi Muslim sect armed with automatic weapons, machetes, and small arms took over the B'nai B'rith Building, the Islamic Center, and the District Building in Washington, D.C., and held 134 hostages. The siege lasted for 39 hours and resulted in the death of 1 person and several injuries. During the siege it was determined that one of the perpetrators was of prior record with this Service. Information regarding this individual was released to another law enforcement agency to assist in the negotiations. Again, the unconsented-to disclosure of information to other law enforcement representatives by the Service is infrequent and occurs only when it is felt it would be of assistance in a life-threatening situation. This type of disclosure is permitted by the Privacy Act of 1974.

Exhibit 35.—Press release, June 21, 1979, concerning continuation of operation of the U.S. Assay Office at New York

The Treasury Department announced today that it had completed a reorganization of the New York Assay Office and has determined that the facility will continue in operation until the remaining unrefined bullion is processed, which it is estimated will require four or five years. The Assay Office is the only Federal facility that still refines gold and silver bullion.

Enhanced security, accountability and staffing procedures have been implemented. "A spirit of cooperation with the labor force, union officials, largely through the efforts of the Superintendent of the New York Assay Office, has been fostered" stated Robert Carswell, Deputy Secretary of the Treasury. "This has resulted in an extraordinary effort on the part of the employees to reduce costs and thereby save the refining operation."

An updated cost comparison for refining the remaining 16 million ounces of unparted gold bullion at the New York Assay Office has been completed. The Assay Office costs are considerably lower than the best bid received from the private sector. Since the beginning of the fiscal year, substantial progress has been made in reducing costs and increasing productivity. The output of refined gold has increased by more than 25 percent since October of 1978. At the same time the work force has decreased from more than 190 employees to 165 employees by attrition.

The Treasury Department estimates that the increase in productivity will result in a savings of about $300,000 in fiscal year 1979 and $400,000 in fiscal year 1980. It is estimated that the remaining unrefined gold bullion will be refined in approximately five years and that the refinery will close when the job has been completed. The Treasury Department will carefully monitor production costs and staffing during the remaining years of operation in order to make certain that the high productivity is maintained.

The Assay Office, situated in Lower Manhattan, was established in 1854.

Exhibit 36.—Statement by Assistant Secretary Davis, July 12, 1979, before the Senate Energy Research and Development Subcommittee of the Senate Committee on Energy and Natural Resources, on title VIII of S. 1308 relating to the use of alcohol motor fuels.

I appreciate the opportunity to appear here today to respond to certain questions relevant to your consideration of title VIII of S. 1308 relating to the use of alcohol motor fuels. The questions you have raised, and to which I will address myself, involve the gasoline excise tax exemption, the applicability of the investment tax credits included in the 1978 Energy Tax Act, and the regulatory procedures of the Bureau of Alcohol, Tobacco and Firearms (ATF). I am accompanied by Mr. Thomas George, Chief, Regulations and Procedures Division, Bureau of Alcohol, Tobacco and Firearms and by Mr. John Copeland of the Office of Tax Policy.

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Permanent extension of gasoline tax exemption

In a message sent to the Congress on June 20 the President recommended an extension of the exemption for gasoline/alcohol mixtures ("gasohol") from the Federal gasoline excise tax. This exemption was initially included in the Energy Tax Act of 1978 which exempted fuel containing a mixture of at least 10 percent alcohol from the 4 cents per gallon Federal excise tax on gasoline, but only through September 30, 1984. Under the act the blend of gasoline and alcohol must consist of alcohol which is methanol or ethanol, but which does not include products of petroleum, natural gas, or coal.

Alcohol can be used as a petroleum supplement and octane booster which could help moderate current pressures on U.S. oil supplies. Since enactment of the 4 cents subsidy in 1978, gasohol sales in fact have risen rapidly. However, little interest has thus far been exhibited by commercial producers seeking to expand or build new commercial production facilities for gasohol. Development of these facilities, with the accompanying economics of scale, would help reduce the cost of producing gasohol in the future. Permanent extension of the gasohol exemption from the Federal gasoline tax, however, could significantly increase the incentive for production of this fuel by providing the continued demand for the product that new investors need. It is hoped, therefore, that this proposal will further assist in the development of our capability to produce gasohol.

The proposal will also make a technical change to existing law. The 1978 Energy Tax Act did not provide a mechanism for persons who pay the excise tax to claim a credit or refund of the excise tax paid if the gasoline is mixed with alcohol. The Technical Corrections Act of 1979 (H.R. 2797) contains such a provision. The administration's proposal will make this technical correction in the event H.R. 2797 is not adopted.

Energy investment tax credit

You have also requested that I discuss the applicability of the investment tax credit to gasohol production.

Section 301 of the 1978 Energy Tax Act provides for a 10-percent energy investment tax credit (in addition to the regular 10-percent investment tax credit) for "alternative energy property." Alternative energy property includes "equipment for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel (other than coke or coke gas)" and an "alternate substance" means "any substance other than oil and natural gas and any product of oil and natural gas." Thus, equipment for producing alcohol from a substance other than oil and natural gas and their derivatives would generally qualify for the energy investment tax credit provided, of course, that the alcohol produced is used as a fuel.

The additional 10-percent investment tax credit is available for acquisition of property after September 30, 1978, and before January 1, 1983.

ATF regulatory procedures

ATF has responsibility for assuring the collection of the excise tax on alcoholic beverages. Since, in 1978, this tax produced some $5.4 billion and involved a tax of $10.50 a proof gallon on distilled spirits, Congress has mandated and ATF has implemented numerous requirements to protect the revenue.

The system of regulations created by current statutes does not really consider the needs of those producing alcohol for use as fuel. It is for this reason that S. 1200, an administration proposal introduced by Senator Bayh and 15 cosponsors, would provide the Secretary with the authority to waive these regulatory requirements for those producing alcohol for mixture with gasoline, while allowing discretion to react to future developments or problems which may arise. This proposal, and our preliminary plan for implementing it, are discussed below. This legislation would particularly assist the small- and middle-size producers of gasohol such as the farmer and farm cooperative. In the meantime, also as discussed below, ATF has been using the provisions for experimental distilleries temporarily to allow the development of gasohol facilities with the minimum burdens possible.

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There are two types of distilled spirits plants (DSP's) presently authorized by law. The first is the commercial DSP—this distiller is authorized to produce beverage or industrial alcohol. The second type of plant is the experimental DSP. This authorization is for any person who experiments or develops sources of materials for distillation, processes of distillation, or industrial uses of alcohol. The commercial DSP is authorized by section 5171 of the Internal Revenue Code. The Code requires that this type of plant be located on a commercial premises, have a continuous and closed distilling system, and provide adequate facilities for all operations, which may include production, warehousing, denaturation, and bottling. Extensive requirements also govern the location, construction, arrangement, and protection of the DSP.

In order to further protect revenue the distiller is required to give bonds to cover his potential tax liability. Bonds are required for production facilities and for storage facilities. The Government also is given a first lien on the distiller's plant. If the distiller does not own the property on which the plant is located he may also be required to file an indemnity bond in lieu of this lien.

While this system will be changed by the MTN implementing legislation, the commercial distiller's operations are under direct onsite supervision. ATF stations inspectors at DSP's to monitor all phases of production and storage. ATF literally maintains the distilling system and the alcohol under Government lock and key.

The present law also requires that, in order for alcohol to be removed from the DSP free of tax, it must first be denatured. "Denaturation" may be defined as the destruction of the beverage character of the alcohol; that is, it is rendered unfit for beverage use. Segregated facilities are required for the DSP proprietor to denature alcohol and only a DSP may denature alcohol. In addition, in the past the approved denaturation formulas have been limited. As discussed below, new formulas have been developed to ease the production of gasohol.

The commercial DSP also has substantial recordkeeping requirements, which include many types of records detailing all production, storage, rectification, bottling, and other operations. Numerous reports and returns are required semimonthly, monthly, and annually.

While ATF continuously evaluates its supervisory role and the purpose of the required records and reports, and attempts to regulate the alcohol industry with the minimum of intrusion, the regulatory scheme mandated by the Internal Revenue Code does not meet the needs of an alcohol fuel industry. The requirements for the commercial DSP are too extensive for many fuel producers, and prohibitive for the small- and middle-size producer.

The other type of plant presently authorized, the experimental DSP, provides only a temporary and extremely limited alternative. The experimental DSP is authorized to produce alcohol for experimental or developmental purposes only. No alcohol may be sold or given away. All alcohol produced must be used in experimental processes at the plant premises, with certain exceptions. This authorization, granted by section 5312 of the Code, is intended for bona fide research and experiments. It is valid only for a limited period of time, generally 2 years. Due to these limitations, the experimental DSP is not subject to the extensive controls and requirements mandated for the commercial distillery. The experimental distiller has no onsite supervision and no required reports. This proprietor is, however, currently required to file a bond to cover his potential tax liability and is required to maintain records detailing his production and disposition of alcohol.

In 1978 there were 18 applications for experimental DSP authorizations. All of these applications were granted. Since January 1, 1979, ATF has received 2,042 applications for the experimental DSP: all of these are fuel related, and most are individuals who want to produce fuel for their personal use. Although it is not actually clear that this use of the experimental DSP provisions were contemplated when this legislation was enacted, ATF has moved to approve these applications under section 5312, since there is no other provision for them under current law.

Approval of these applications is only a short-term and unsatisfactory solution for those who are seeking alternative fuels, however. These plants may not produce fuel alcohol for sale, their authorization is for a limited period of time, and many of those who have made this application have experienced difficulty in obtaining the requisite surety bond. The lack of clear statutory authority and of established guidelines

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regulating these plants also creates the kind of confused situation which produces the risk of diversion of this alcohol to the beverage market.

ATF has waived all regulatory requirements within its waiver authority. The one remaining area where further relief is possible relates to the bond requirement. ATF has tentatively approved approximately 95 percent of the nearly 2,100 applications, yet only 113 have been authorized to operate (the Bureau cannot issue an authorization without an approved bond). ATF has determined that it can waive the bond requirement for experimental DSP's without undue risk to the revenue and a final rule is being prepared to do so. The experimental DSP procedures remain, however, stopgap at best.

The proposed legislation—S. 1200—now before the Congress will provide the Department with the flexibility required to meet the needs of the alcohol fuel industry. This legislation provides for a third type of DSP—the fuel producer. This bill authorizes the establishment of plants which may produce alcohol for fuel purposes only. The distiller may remove the alcohol free of tax after rendering it unfit for beverage purposes. This legislation would give the Secretary broad authority to waive existing regulatory requirements for these new types of plants. We have also attached to the legislation a paper describing how, subject to Congressional and public comment, we plan to implement this statute, if passed. I would like to submit a copy of this plan for the record. [1] Our plan necessarily, however, might change over time. Based on our experience, we may discover that further liberalization is possible. At the same time, it must be recognized that our proposals do increase the risk of illegal "moonshining" and, if problems develop, regulatory action to deal with that problem may have to be taken.

We envision a regulatory scheme which provides for intrusion only to the degree necessary to protect the revenue. Under the proposed plan, the fuel producer plants would be regulated in direct proportion to the danger they present to the revenue, based on their production. We propose to establish three categories of alcohol fuel producers—the small, medium, and large alcohol fuel distiller. A small producer would be one who makes up to 5,000 proof gallons per year; the medium producer would produce from 5,000 to 100,000 proof gallons per year; and the large producer would produce in excess of 100,000 proof gallons per year. A proof gallon is one liquid gallon of 100 proof alcohol.

While specific regulatory controls will vary at each level of production, all fuel alcohol plants will be expected to file a simplified application; denature their alcohol; maintain some security necessary to prevent diversion of alcohol to uses other than fuel; and maintain limited records with respect to production and disposition of the alcohol. The small producer would not be required to file a bond; but the medium and large producers would be required to give a surety bond.

One planned reform is to simplify the application procedure. While the present commercial distiller may be required to file as many as 20 different forms and additional documentation such as detailed drawings and plans of the distillery, the fuel producers will be required to file only 1 basic form—the application. The large producer would also be required to file certain other forms giving more details about the plant's operations, facilities, equipment, and business structure.

At the present time all distillers who also store alcohol must give a surety bond with the minimum penal sum of at least $10,000 up to a maximum penal sum of $200,000. The bond is calculated on the potential tax liability for alcohol produced and stored during any 15 consecutive days under our plan. The small fuel producer would not be required to file a bond. The medium and large producers will be required to give a bond in order to minimize the risk to the Government of any loss of tax revenue and to protect the plant itself from tax liability on any alcohol diverted unlawfully to nonfuel purposes.

The law now also requires every distiller to have a continuous and closed system. A closed distilling system may be described as one in which the alcohol can be removed only at one point. ATF can thereby assure that all production is then properly accounted for.

[1] Not included in this exhibit.

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Under our proposal the small producer need not have a closed distilling system, but need only be able to accurately determine the proof and quantity of his production and to store the alcohol in a secure storage facility. The basic equipment necessary to determine the proof of the alcohol is not expensive nor sophisticated.

The medium producer would similarly be required to be able to gauge his production, again with inexpensive and simple equipment. The medium producer would only be required to have a closed system in the instance of a plant operated by a number of individuals, for example, a farm cooperative. The medium producer who is required to have a closed system would, however, use his own seals and locks. This producer would also be required to have a storage facility which he can lock. No additional security measures would be required.

The large producer will be required to have a continuous and closed system and ATF will maintain security with Government locks and seals or by meters installed by the proprietor. If the MTN implementing legislation is adopted, this requirement will be eliminated for these producers as well.

The proposed requirements for construction are comparable to the present requirements for commercial distillers only in the case of the large producer. The small and medium producers have substantially less restrictive requirements due to their significantly smaller volume of production.

The present commercial distiller is required to provide substantial security for the distilling system and the alcohol. The security measures which the fuel producers may be required to provide are only those necessary to prevent theft or unauthorized removal of alcohol. It is possible that the small and medium producers will not be required to implement any security measures beyond those which they might already deem necessary simply to protect their property.

The present commercial distiller is also now required to file numerous reports and returns and to make numerous records. Under our plan the small producer will be expected to maintain a record only of the quantity and proof of the alcohol produced; the quantities and types of materials added to the alcohol to destroy the beverage character; and, of the disposition of the denatured alcohol. Once a year, the small producer will file a report with ATF stating the volume and proof of alcohol produced annually and the disposition of the denatured alcohol.

The medium producer will be expected to maintain records of volume and proof of alcohol produced; the quantities and types of materials used to destroy the beverage character of the alcohol; and, the disposition of the alcohol. This producer will be expected to file a semiannual report with ATF giving the details of production on a monthly basis and of the disposition of its alcohol fuels.

The large producer will be expected to maintain records of volume and proof of alcohol produced; the quantities and types of materials used for denaturation; and the disposition of its denaturated alcohol. Additionally, the large producer would be expected to maintain records of the materials received and used to produce alcohol. The large producer will file a quarterly report providing details of the volume and proof of alcohol produced by months and of its disposition.

Present commercial distillers are required to denature alcohol using specified formulas requiring substances such as gasoline, kerosene, and other chemicals. At the present time denaturation must be accomplished either under the direct supervision of ATF inspectors or through metered systems. ATF will work with the fuel producer to develop an acceptable formula which will meet his specific needs. For example, we now plan to authorize the denaturing of alcohol by using as little as 10 gallons of gasoline for every 100 gallons of alcohol. This should provide substantial assistance to the gasohol producer.

We believe that the changes in the law which have been presented in our proposal will then provide the Bureau and the Government with the flexibility to be responsive to the varying demands and considerations for fuel producers, both big and small, from the commercial plant which produces millions of gallons annually, to the home producer who makes only enough fuel to run his farm or heat his home. We have articulated a plan to implement this legislation. We welcome any further suggestions to improve it. We hope to respond to the needs of today with a program which will protect the revenue while easing the burdens and obstacles which the fuel producer faces. While we are now utilizing stopgap, interim measures to provide for immediate

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authorizations for fuel producers, if S. 1200 is adopted it would remove the obstacles which prevent maximum alcohol production and would allow the alcohol fuel producers to make the maximum contribution to the American people with the minimum regulation.

Exhibit 37.—Remarks by Assistant Secretary Davis, September 28, 1979, at the conference of the International Narcotic Enforcement Officers Association, Honolulu, Hawaii, on the Bank Secrecy Act

It is a pleasure for me to be here this morning and participate in your meeting. I know, from my service as a prosecutor, of the enormous problems involved in narcotics enforcement. You and your colleagues are truly in the forefront of one of the most brutal and difficult struggles that anyone in law enforcement must face. The stakes are high for the major criminal participants; the potential profits are large, but so are the potential jail sentences they face. Violence is part of the everyday fabric of drug dealing, and danger is ever present for those who seek to stop it.

During your conference you will hear many discuss various aspects of narcotics enforcement. I would like to tell you about some of the things we are doing within Treasury to support the Federal narcotics effort.

The word Treasury immediately suggests money to most of us so it may not surprise you to learn that I am going to talk about our activities in the financial area—more specifically, our implementation of the Bank Secrecy Act and our interagency agreement to improve the use of economic development programs to discourage the cultivation of narcotics in source countries.

During the last 2 years, we have greatly increased our efforts to improve the implementation of the Bank Secrecy Act. As a result, we have been able to provide DEA with information concerning drug-related transactions; we have been able to provide increased opportunities to use this law to prosecute drug traffickers for their illegal financial activities; and we have formed the basis for a strengthened attack on those who help the drug dealer launder his money. All too often, in the past, the financial aspects of the narcotics business have been neglected by law enforcement officers. Now with the active leadership of DEA and Customs, I hope that we are at a point where the potential of this investigative weapon can be realized.

First, what is the Bank Secrecy Act? What does it try to accomplish? The act was passed in 1970 to ensure the maintenance of records by financial institutions and to require reports of certain financial activities where those records and reports "have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings."

The investigations or need for the act was well documented during the congressional hearings which preceded its passage. Representatives of major Federal law enforcement agencies testified about the problems of investigating the financial activities of criminals, especially when foreign transactions are involved. Witnesses from Defense, Justice, State, Treasury, and the SEC described how foreign accounts are used in black marketing, bribery, smuggling, securities violations, and tax evasion. One of the more sensational cases cited was a drug violation which some of you may recall. It involved heroin smuggled into the United States from Europe disguised as canned food, and the movement of money in ways that remain common. The proceeds, amounting to $950,000 were sent to a European bank account of a Latin American shell company known as the Me Too Corporation. Couriers delivered $800,000 in currency to two foreign exchange firms in New York. From there the funds were transferred to the European bank account. The other $150,000 in currency was deposited with a large New York bank for the account of a South American brokerage firm. Those funds were later transferred by check to the same European bank.

On the strength of such testimony, the Bank Secrecy Act was passed and implementing regulations issued by the Treasury Department in 1972. Those regulations contain the following provisions:

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- Banks and other financial institutions are required to maintain basic records such as signature cards, statements, and cancelled checks for 5 years.
- Financial institutions are required to report currency transactions in excess of $10,000 to the IRS (Form 4789).
- Persons transporting or causing the transportation of currency and other monetary instruments in excess of $5,000 into or out of the United States are required to report it to the Customs Service (Form 4790).
- Everyone who has a financial interest in or signature authority over a foreign bank account must report it annually to Treasury (Form 90–22.1).

It is clear that these provisions provide real tools in the fight against the traffic in drugs. They assist us in following cash movements and provide obstacles to the laundering of funds. And, after all, crime is a cash business and illegal drugs appear to be one of the most widespread and lucrative underworld activities.

According to recent estimates published by the IRS, the income from illegal drug activity in 1976 could have been as much as $23 billion. Today, the amounts are likely higher. Since much of this huge amount of money, at one time or another, is in the form of U.S. bills, it often finds its way into the U.S. banking system to be laundered. For this reason, the Bank Secrecy Act, properly implemented, should be extremely valuable to drug enforcement officers.

As I have indicated, if money is carried out of the United States to pay for drugs, it must be reported. Unless it comes back through the banking system, it must also be reported when it is returned to the United States. Failure to do so is a crime, a crime which sometimes can be prosecuted more easily than narcotics charges. If drug receipts are deposited in large amounts in domestic banks, the banks must report the deposits. Some of these reports are currently being made available to DEA.

As many of you know, the Customs Service has the responsibility for enforcing the provision that requires reports of the international transportation of currency in excess of $5,000. During the last 2 years, Customs has greatly increased its commitment of resources to this area. During fiscal year 1978, Customs made 639 seizures involving more than $12.9 million and obtained 26 convictions. Some of the cases have been worked jointly with DEA and other agencies and have resulted in substantial criminal penalties. In one instance, three defendants were each fined $500,000, the maximum permitted by the Bank Secrecy Act. In another case, customs agents in Chicago and Los Angeles are investigating Bank Secrecy Act violations of a large heroin-trafficking organization involving the unreported transportation to Mexico of about $35 million annually.

Another case that I recently reviewed involved the seizure of more than $300,000 in currency and cashiers checks that a female courier, travelling on a Colombian passport, attempted to smuggle out of the United States. She was stopped and searched at the airport and the money was seized. She was subsequently convicted on a conspiracy charge. And, Customs still has the money. The ability to seize the money involved and levy heavy civil penalties is an important element of this statute.

Obviously, there have been a number of other significant cases where Customs has used the Bank Secrecy Act against suspected drug violators; however, I would also like to talk about the requirement that domestic financial institutions report currency transactions in excess of $10,000. The Federal bank supervisory agencies have responsibility for checking for compliance by banks with these provisions. The IRS, however, has been given the responsibility for investigations of potential criminal violations. While there have not been a large number of prosecutions, our emphasis in this area is increasing. The most publicized case so far has been the Chemical Bank case in New York. In 1977, the bank pled guilty to 445 misdemeanor counts of failing to file reports and was fined $222,500. The case arose from a narcotics investigation. A number of branch bank management people went into business for themselves. For a small commission, they gave traffickers large denomination bills, $50's and $100's, for smaller ones.

In another case earlier this year, in Texas, the former Chairman of the Board of a bank, was convicted of failing to report the disbursement of $45,000 in currency in connection with a loan he made to a cocaine dealer. Apparently the banker knew what the money was to be used for but was persuaded to make the loan by his mistress. The

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principal Government witness was the cocaine dealer. The judge imposed a sizable fine in this case and a prison sentence, reminding all of the seriousness of this offense.

In addition to these convictions, the reporting requirements have been useful in providing leads to DEA. During the last 24 months, we have provided DEA with copies of about 3,000 reports reflecting currency transactions in excess of $400,000,000. As a matter of fact, we are so convinced that these reports, as well as the others required under the Bank Secrecy Act, are valuable that Customs has established a special unit to handle them. It is part of the Currency Investigations Division at Customs and is called the Reports Analysis Unit.

The unit is responsible for the analysis of the reports and dissemination of the report information to other Federal agencies. The reports are being computerized so that the unit can be more responsive to requests for data.

In connection with our interest in the use of currency for criminal transactions, we recently conducted a study, based on Federal Reserve figures, of currency flows in Federal Reserve offices throughout the United States. The findings, though not surprising, are instructive: In 1978, 30 Federal Reserve offices paid out $14.4 billion more in currency than they received. The other 7 offices received $4.2 billion more than they paid out. Two of these offices which service Florida accounted for more than $3.2 billion of the surplus. The offices in Jacksonville and Miami had a net surplus almost as large as the net amount of currency paid out by the office in New York which dominates currency operations in the United States. Another striking fact is that the surplus in Miami is currently growing about 50 percent a year. We estimate that it will reach $4.5 billion this year.

Half of the Miami surplus is in $20 bills not the $50's and $100's that people frequently associate with large-scale criminal activity. However, we believe that given the other facts known to us, much of this surplus may stem from criminal activities, likely drugs.

Therefore, the Department is developing a plan for gathering additional information about the currency flow in Florida which will provide us with a better idea of the source of the funds and furnish leads to possible violations of the Bank Secrecy Act, the tax laws, and other Federal statutes. We are determined here, and in other parts of the country, to make it clear that any illegalities and failures to report by financial institutions, as aiders of illicit activities, will be dealt with severely.

I would also like to take this opportunity to tell you a little about the interagency agreement for the sharing of information concerning the narcotics-producing regions of the world. This agreement went into effect in March of this year as a product of the President's Strategy Council on Drug Abuse. It is part of the implementation of the President's commitment to use all types of resources to deal with this problem.

The purpose of the agreement is to improve the availability of information about narcotics-growing areas of the world to those agencies and officials of the U.S. Government who participate in international development loans and projects. It is anticipated that the increased availability of such information will help them to channel economic development for narcotics-producing areas into alternative crops and rural development, thus reducing the amount of narcotics available for nonmedical drug use.

The United States and other countries throughout the world face a continuing problem of drug abuse and drug addiction. The cost of this problem in human suffering and wasted lives is too high. And, once the drugs arrive here, as we all know too well, the difficulties only increase. One way to attempt to reduce the availability of drugs, therefore is to curtail the cultivation of narcotics by promoting measures which will encourage narcotics producers to produce alternative crops.

The United States participates on its own and through international financial institutions or the United Nations in extensive economic assistance and loan programs throughout the world. These programs frequently involve the financing of agricultural and rural development. It is the underlying philosophy of this agreement that the economic assistance programs are one way of encouraging the substitution of alternative crops for narcotics.

This goal is not new, but its full implementation has been hampered by the lack of an institutionalized mechanism to provide the economic assistance and development agencies with the information required to target assistance programs so as to

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contribute to reducing narcotics cultivation. The purpose of this agreement is to accomplish this as well as to provide a basis for monitoring the activities of both our own and the international agencies active in these areas.

It is hoped that through this system of coordination, as well as through tough enforcement and utilization of the Bank Secrecy Act, that we will be better able to carry out the difficult task of dealing with the narcotics problem.

Tax Policy

Exhibit 38.—Excerpts from statement by Secretary Blumenthal, January 29, 1979, before the House Ways and Means Committee, on the administration's proposal for real wage insurance.

I am grateful for this hearing in the administration's proposal for real wage insurance. This innovative proposal offers the Congress a unique opportunity to strengthen the Nation's fight against inflation, and I hope the committee will give the proposal serious, expeditious, and positive consideration.

* * * * * * *

Legislative Proposal

Real wage insurance (RWI) will give a tax credit to workers in groups receiving average pay increases of 7 percent or less, if inflation exceeds 7 percent in 1979. The tax credit is computed as a percentage of the first $20,000 of an employee's 1979 wages. This percentage is the number of percentage points, up to 3, by which inflation exceeds 7 percent.

I. Reasons for the program

This proposal is an integral part of the anti-inflation effort. It supplements the President's initiatives to limit Federal spending, cut the budget deficit, and reduce the economic burdens of regulations. These actions will create an environment in which a voluntary program of wage and price restraint can be effective and lasting.

The essential purpose of real wage insurance is to reinforce the voluntary pay standards by giving workers an additional incentive to accept average pay increases of 7 percent or less. In times of inflation, employees often believe that a large pay increase is their only defense against a steady erosion of real income. Yet, higher labor costs are quickly passed on in higher prices. The present inflation clearly reflects the momentum of price and wage increases that have become built into the economy in recent years. Slowing this inflationary momentum is the most important challenge of domestic economic policy.

Real wage insurance will help to break the cycle of inflation by assuring groups of workers that they can cooperate with the pay standard without the risk of being penalized by an acceleration of inflation—from whatever source. This point deserves emphasis: Unlike other anti-inflation proposals that are often suggested, RWI hits at the core of the wage-price spiral. Everyone involved in that spiral knows that self-restraint will break the spiral if most of us exercise that self-restraint. But no one wants to go first. If one employee group shows restraint, but others do not, that group knows it will be penalized; its wages will be restrained, but prices generally will keep on rising. So everyone avoids restraint, even though everyone knows that this guarantees more inflation. RWI offers a sensible remedy for this general frustration of the general interest. RWI allows unions and other employee groups to take the first step toward wage restraint without risking adverse consequences if others do not similarly cooperate or if other inflationary events occur.

RWI is the natural and logical complement of a voluntary system of pay and price restraints. It rewards responsible voluntary behavior. A voluntary system, fortified by RWI, is far less intrusive and cumbersome and far more equitable than a system of mandatory controls.

Real wage insurance is not a general tax cut, nor a device to compensate all workers for the effects of inflation. It is an incentive for responsible pay behavior. To cut taxes

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or provide general inflation relief without a requirement of wage restraint would actually fuel inflation by adding to the budget deficit and by weakening employers' resolve to restrain costs.

Real wage insurance is the opposite of indexing. It is tax policy applied to retard inflation rather than to accommodate inflation.

This program can help to reduce inflation. Based on historical distributions of pay increases among various groups of workers one can predict that a large percentage of U.S. workers would receive pay increases in excess of 7 percent in 1979, in the absence of wage restraint. Many of these workers are not yet "locked-in" by continuing contracts or other mandated raises. If 60 percent of these are persuaded to accept 7 percent pay increases, the average increase in pay for the country will be reduced by about 0.7 percentage points in 1979. This moderation of pay increases will be passed through to reduce the rate of price increases for most items. Overall, the rate of price inflation (including food and fuel prices) will be reduced by 0.5 percentage points as compared to what it would have been in the absence of wage restraint. The passthrough of wage deceleration into prices is specifically required for compliance with the price standards and is shown by historical relationships to be a normal response.

II. General explanation

The proposal is designed for *effectiveness* in moderating the rate of increase in labor costs. Effectiveness depends upon the link between wage performance and potential rewards. Every employee group (except those of small businesses choosing not to participate) is subject to a test of pay-rate increases. In the case of new collective bargaining agreements of more than 15 months' duration, this test is a prospective evaluation under the pay standard recently announced by the Council on Wage and Price Stability (CWPS). In other cases, an end-of-the-year calculation of the annual pay-rate increase will be made according to rules set forth below. In either instance, *RWI is available to an employee group only if the average annual pay increase for the group is 7 percent or less.*

The proposal combines effective incentives for wage restraint with limited budget exposure. The objectives of effectiveness and *cost control* are both served by insisting that groups must hold pay increases to 7 percent or less to receive wage insurance. A high rate of compliance will slow inflation; slower inflation will reduce, and may eliminate, the budget cost of real wage insurance. Budget risk is also reduced by limiting the amount of covered wages from any one job to $20,000 and by limiting the wage insurance rate to 3 percent, thereby protecting for inflation up to 10 percent. Such limitations are prudent, but not overly restrictive. The $20,000 limit will allow full coverage of wages for 88 percent of employees, and will provide coverage for 87 percent of total wages for qualified workers. Similarly, the 10-percent inflation limit will curtail payout of RWI only if inflation substantially exceeds the range of professional forecasts for 1979.

The rules for real wage insurance are designed for *simplicity,* to the extent possible, given other goals of the program and the variety of pay practices used by businesses. The amount of insurance is based entirely on pay as normally reported for tax purposes. The rate of credit is the same for everyone. RWI will add only one line to the individual Federal income tax return. Payment would be made through the regular process of Federal income tax refunds and payments.

Employers will divide their employees into groups and determine whether each employee group qualifies. The rules for grouping and for qualification generally follow the standards recently published by CWPS. However, the rules for real wage insurance are somewhat simpler and have fewer options and exceptions. The simplified rules are intended to hold down the number of calculations and records required of smaller businesses and to facilitate their verification (when necessary) by the IRS.

Employers will not be required to report computations of pay-rate increases to the Government, although the employer's determination will be subject to verification by IRS. Small businesses with fewer than 50 employees may choose to refuse RWI and thus avoid any calculation of average pay increases.

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Every member of every employee group meeting the test of a 7-percent or smaller pay increase is qualified for wage insurance whether or not the group is covered by the CWPS standards. In other words, even those groups automatically exempted from the CWPS standards (i.e., low-wage workers and workers under continuing contracts) are eligible for RWI. Groups of employees are disqualified only if they have wage increases above 7 percent, or they are employees in small businesses choosing not to participate, or they are in a position to set their own wages (such as owner-managers of corporations). To accommodate RWI to the collective bargaining process, special rules apply to collective bargaining agreements of more than 15 months' duration negotiated during the program year. These agreements are evaluated *as of the time of settlement* so that the parties may be assured in advance of RWI coverage. Average pay increases must be 7 percent or less over the life of the contract. For all other groups, qualification is determined as of the close of the program year.

A. *Computation of RWI credit.* Employees who are members of qualifying employee groups will receive a tax credit if inflation exceeds 7 percent. The amount of this credit will be determined by multiplying the employee's 1979 earnings from qualified employment by the difference between the rate of inflation for the year and 7 percent. For example, if the rate of inflation in 1979 is 8 percent, the amount of RWI credit reported to an employee earning $10,000 of taxable wages in 1979 would be $100. The amount of wages qualified for wage insurance is limited to $20,000 from any one employer. The rate of credit is the same for all qualified persons.

The rate of inflation for the year will be measured as the percentage increase of the average Consumer Price Index (CPI) for October and November 1979 over the average CPI for October and November 1978. This measurement period covers calendar year 1979 as closely as possible while still allowing the government to announce the rate of RWI credit before the end of December 1979, in time for employers to prepare W-2 forms.

The rate of RWI Credit will be limited to 3 percentage points of inflation. Thus, qualified workers will be insured against loss of real income due to inflation up to 10 percent in 1979.

The program may also be extended to a second year. The President must order the extension and may reduce the target inflation rate for the second year by Executive order on or before December 1, 1979. Congress must then approve the Executive order by joint resolution within 30 legislative days for the extension and new target rate to become effective. Special procedures will facilitate congressional action by limiting the amount of time a committee may take to consider a joint resolution, after which it will be brought to the floor.

The RWI credit is intended to supplement wages for those groups foregoing wage increases above 7 percent. In general, the tax credit will be treated as if it were an additional wage payment and, consequently, will be subject to Federal income tax as 1979 wages. However, RWI will not be subject to FICA or FUTA taxes.

B. *Qualification.* Any employee receiving a W-2 form for earnings in 1979 is potentially eligible for RWI. This includes Government employees, domestic workers, and farm workers, but excludes the self-employed. The only specific exclusions are for wages reported by a company to an employee not a resident in the United States or to one who owns 10 percent or more of the company's stock. These latter earnings, like those of the self-employed, are often hard to distinguish from profits.

An individual obtains coverage by being a member of an employee unit that qualifies. This rule of group qualification is very important. Like the voluntary CWPS pay standard, the RWI program aims to restrain a company's average pay increases. If the 7-percent standard and RWI applied on an employee-by-employee basis, rather than a group basis, they would not have a beneficial impact on the economy. First, it is a company's average pay increase that affects its prices If RWI operated on an individual basis, it would be available even where average pay increases exceeded the 7-percent standard. Thus, RWI would not act as an effective anti-inflation incentive for company-wide decisions about the pay of its various union and nonunion employee groups. Second, an individually based program would create perverse incentives. Individual employees would be encouraged to avoid promotions, overtime work, merit bonuses, and the like. That is, the program would stifle productivity. Third, an individually based program would interfere in complex ways with each company's

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pay system. By contrast, a group-based standard leaves each company and its employees free to allocate pay among workers in the most efficient and equitable manner.

The group standard also greatly simplifies the administration of the program. For each group, it is necessary only to divide pay by hours worked, information readily available to employers. An individually based program would require that pay-rate calculations be made for every job held by every worker in the economy—about 140 million separate calculations.

Employees of a company will be divided into four types of employee units: (1) Employees subject to collective bargaining agreements, (2) low-wage workers, (3) management and supervisory employees, and (4) all others. Employers will determine the qualification of each employee unit for RWI.

To determine qualification, employers perform the computations described below. These computations need not be reported to the IRS, but must be available for possible verification.

Step one: Separate employees into groups. The qualification of those under new collective bargaining agreements is determined contract-wide as of the time the contract is signed. All other groups are separately tested by the employer after the end of the program year (October 1978–September 1979).

Collective bargaining units that sign new agreements of more than 15 months' duration after October 24, 1978, and before October 1, 1979, will qualify for RWI if annual pay increases under such agreements average 7 percent or less according to the rules for new collective bargaining agreements published by the Council on Wage and Price Stability (CWPS). All employees covered by such agreements are qualified, wherever they work. Other employees in the same company whose pay maintains a historical tandem relationship with such agreements are also qualified. Qualification will be based upon the terms of the agreement evaluated prospectively as to the date of the agreement. Thus, for example, agreements that contain cost-of-living adjustments will not be subject to reevaluation if later events reveal an inflation rate different from the 6-percent rate specified in the CWPS rules for evaluating agreements.

Step two: Compute base quarter pay rate. For each remaining group, the employer determines total taxable straight-time wages for employees in the group for the third calendar quarter in 1978. To this total amount is added 25 percent of bonuses and other irregular payments made during the base year (October 1, 1977, to September 30, 1978). The resulting sum is divided by the total straight-time hours for which employees are paid in the quarter. The result is the "base quarter pay rate."

Step three: Compute program quarter pay rate. Next, the employer makes the same calculation for the third quarter 1979 including 25 percent of irregular payments in the program year. If there have been changes in the structure of benefit plans, such as for pensions, medical insurance, and educational assistance, 25 percent of the change in the annual cost of these benefits also is added to (or subtracted from) taxable wages in calculating the "program quarter pay rate." The benefit rule is necessary to avoid an obvious loophole—the substitution of fringe benefits for cash wages. An employer may also adjust the program quarter pay rate for changes in hours of employment among establishments within the company.

Step four: Determine qualification for RWI. If the program quarter pay rate for an employee group does not exceed its base quarter pay rate by more than 7 percent, the group qualifies for real wage insurance.

C. *Payment of real wage insurance.* For each member of qualified groups, the employer will add the real wage insurance credit to other amounts reported as wages on the employee's Form W-2 and also report it in a separate space on that form. The Federal income tax return of an employee will have only one additional line—for the amount of real wage insurance credit. This amount will either increase the taxpayer's refund or reduce taxes owed in the same way as amounts withheld. The full amount of refund will be paid even if it exceeds the employee's tax liability or if the employee has no tax liability. The RWI credit is included in taxable income, but this involves no change in tax return preparation because it is included by copying wage amounts from the W-2, as always.

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Thus, real wage insurance involves a minimum amount of additional effort for the individual taxpayer and only one additional item for the IRS to check on an individual return. If inflation exceeds 7 percent, those qualified for RWI will receive RWI payments as part of the regular tax refund (or payment) procedure.

The degree of simplicity provided for the individual taxpayer can only be accomplished by specifying the wage limit as $20,000 for each qualified job of an employee. Other types of limitations such as $20,000 of covered wages for each person, would require more lines on the tax forms and more computations for the taxpayer.

D. *Small employers.* The cooperation of small businesses is important to the anti-inflation effort and most will find the offer of real wage insurance beneficial to them and to their employees. However, to avoid imposing additional burdens upon those with special recordkeeping problems, employers with 50 or fewer employees may choose not to participate in the RWI program (except to report RWI credits for union members under qualified new agreements). Employers choosing not to participate must clearly notify their employees of that intention.

III. Revenue cost

The revenue cost of real wage insurance will depend principally upon (1) the rate of compliance among employee groups and (2) the rate of inflation as measured by the change in CPI between October–November 1978 and October–November 1979. These factors are related. Higher compliance will result in reduced labor costs and a corresponding reduction in inflation. Thus, the cost of real wage insurance is partly self limiting, since high compliance can reduce the payoff per qualified worker while low compliance reduces the amount of insured wages.

The administration estimates a revenue cost of $2.5 billion for RWI in its FY 1980 budget. This is based on a forecast inflation rate of 7.5 percent for the relevant period and qualification for RWI by about 47 million employees. About 87 million employees would technically be eligible for RWI, but about 26 million of these will likely be disqualified because existing pay agreements or legal mandates assure them pay increases in excess of 7 percent. The $2.5 billion revenue estimate for RWI assumes that 47 million of the remaining 61 million employees, about three-fourths of them, will qualify.

Alternative assumptions are, of course, possible. For example: If all 61 million realistically eligible employees qualified for RWI, the forecast inflation rate would be 6.6 percent and there would be no revenue cost of RWI. If only about 40 percent of these employees qualified, the forecast inflation rate would be 8.0 percent, and the revenue cost of RWI would be $2.7 billion. Revenue cost estimates that associate very high participation rates with much higher inflation rates are very improbable.

Exhibit 39.—Statement of Assistant Secretary Lubick, March 12, 1979, before the Subcommittee on Taxation and Debt Management of the Senate Committee on Finance, on tax treatment of appreciated property passing at death

I am pleased to appear again before this Subcommittee to discuss the important income tax question of the appropriate tax treatment of appreciated property passing at death.

The tax policy question

Before the Tax Reform Act of 1976 the basis of property acquired from a decedent was its estate tax fair market value. This rule is commonly called "step-up" in basis. The effect of step-up is to forgive forever the collection of any income tax on appreciation that has accrued in property held by an individual at death.

The enactment of carryover basis by section 2005 of the Tax Reform Act of 1976 has prompted volumes of comment that obscure the basic income tax issue "carryover" basis was designed to address. It is appropriate, therefore, to begin by identifying this issue.

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To us the issue is not the workability of the 1976 carryover rules; we shall later in our statement elaborate changes that will solve the technical problems under the 1976 act. The issue is instead whether income tax liability on gains accrued by a decedent at his death are to be entirely and irrevocably forgiven. The defenders of the pre-1976 step-up rule must make a case to justify going back to that result, other than simply that it existed before 1976. The administration is committed to the principle that income tax on appreciation accrued at death should not be forgiven.

Forgiveness is unsound income tax policy

As a matter of income tax policy, step-up is unsound for at least four reasons.

1. *Horizontal and vertical inequity.*—Step-up discriminates arbitrarily among taxpayers and creates significant horizontal and vertical inequities. This can be illustrated by a simple example.

Let us start by assuming that no estate tax is imposed on the transfer of property at death. Further, assume that on the same day two taxpayers, A and B, each bought shares of stock in the same corporation for $10,000. A and B decide to sell when the stock is worth $110,000. Each would pay a capital gains tax of 25 percent on any recognized capital gain. A goes into his broker's office and sells his shares. He walks out into the street and meets his friend B who is about to go into the broker's office to sell his shares. They engage in animated conversation about what each will do with his net after-tax proceeds of $85,000 and fail to observe a speeding vehicle which strikes and kills them both.

A sold his stock before he died. (For purposes of illustration the technical question of when a sale of stock is complete is ignored.) He realized a capital gain of $100,000 upon which an income tax of $25,000 is due. His heir is left with $85,000 after the tax is paid.

Compare B, who has died before he could sell his shares. The shares pass to his heir with a new basis of $110,000. B's heir can immediately sell the shares for that price and pocket the entire $110,000.

Accidental, untimely death has caused A's heir to receive $85,000 and B's heir to receive $110,000. The result gives an unjustifiable advantage to B's heir.

Some assert that the income tax problem so glaringly highlighted by the example does not really exist because the appreciation in the shares owned by B is subject to estate tax. If this assertion is true, the net amount received after payment of both income and estate tax should be the same for A's heir and B's heir.

To test the assertion, assume that the shares or their proceeds in the estates of A and B are both taxed at a 30-percent bracket. A's estate after payment of income tax has assets of $85,000. After the further payment of $25,500 in estate tax, A's heir receives $59,500. On the other hand, B's estate has assets of $110,000. When the shares of stock are sold to pay B's estate tax liability of $33,000, B's heir receives $77,000, $17,500 more than that of A. The combined income and estate tax burden on B's heir is reduced by about 35 percent from the burden on A's heir.

This example demonstrates two basic facts. First, the estate tax and the income tax are two separate tax systems. The estate tax applies to the transfer of property, the income tax to the receipt of income. The estate tax is not a surrogate for the income tax. It applies to wealth accumulated after payment of income tax as well as to wealth that was not subject to income tax.

Second, the example demonstrates the disparate income tax treatment which can occur solely due to the timing of capital gain recognition. Thus, step-up permits those who are able to accumulate wealth in the form of unrealized appreciation to pass on that wealth free of income tax. Those who have recognized capital gains, as well as salaried individuals, can pass on only that which is left after income tax has been paid. Only the wealthiest of American taxpayers are in a position to live comfortably solely on dividends, rents, and interest derived from appreciating assets they are rarely forced to sell. No policy justifies granting this segment of society an income tax advantage over the vast majority who are not in this enviable and privileged position.

This is not an extreme or hypothetical situation. Any tax practitioner can recite from his own experience instance after instance of advice by him to his clients to retain

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assets that would otherwise be sold primarily to secure forgiveness of income tax at death.

Several recent court decisions demonstrate the magnitude of the problem. In *Estate of David Smith,* [1] the Court found the value of scrap metal owned by the decedent to be $2.7 million. Its basis was almost zero. Under step-up, virtually $2.7 million in appreciation passed to the decedent's heirs free of income tax. In *Estate of Henry,* [2] the taxpayer made gifts of marketable corporate stocks totalling $6.7 million with a basis of $115,000. The untaxed appreciation was almost $6.6 million. In *Owen v. Commissioner,* [3] the taxpayer gave marketable American Express Co. stock worth $5.2 million with a basis of $1,200. Virtually the entire $5.2 million passed free of income tax. In *Bradford v. Commissioner,* [4] property worth $2 million with a basis of $283,000 was the subject of the gift. Over $1.8 million of appreciation passed income tax free. In *Johnson v. Commissioner,* [5] the property given was worth $500,000; its basis was $10,800. Almost $490,000 of appreciation passed income tax free.

This phenomenon is not restricted solely to those with inherited wealth. As noted in a recent article in Fortune magazine, "there are dozens—perhaps even hundreds—of individuals who have amassed fortunes of $50 million or more in privately held companies."[6] As the article shows, the initial investment in these enormously successful enterprises is nominal when compared to their current worth.

The impact of forgiveness of income tax at death is more significant as estate size increases. Table 1 demonstrates how estimated appreciation rises as a percentage of the gross estate as estates increase in size.

Table 1.—*Appreciation as a percent of gross estate by size of gross estate*
[1979 levels]

Size of gross estate	Gross estate	Appreciation including personal residence			Appreciation excluding personal residence		
		Amount	As a percent of gross estate	Average per return	Amount	As a percent of gross estate	Average per return
$ 000	*$ millions*	*$ millions*	*percent*	*dollars*	*$ millions*	*percent*	*dollars*
Under 175	25,183	4,386	17.4	18,000	3,242	12.9	13,300
175 - 200	3,291	633	19.2	35,900	479	14.6	27,200
200 - 300	9,037	1,800	19.9	48,200	1,375	15.2	36,800
300 - 500	9,215	2,013	21.8	83,000	1,609	17.5	66,300
500 - 1,000	9,774	2,280	23.3	158,500	1,888	19.3	131,300
1,000 - 2,000	7,082	1,739	24.6	335,100	1,459	20.6	281,110
2,000 - 3,000	3,179	821	25.8	622,400	722	22.7	547,400
3,000 - 5,000	3,101	812	26.2	990,200	708	22.8	863,400
5,000 - 10,000	3,057	833	27.2	1,876,100	752	24.6	1,693,700
10,000 and over	3,365	1,153	34.3	7,161,500	1,114	33.1	6,919,300
Total	76,284	16,470	21.6	47,700	13,347	17.5	38,600

In fact, over 75 percent of appreciation is found in estates of over $175,000, which comprise less than 4 percent of decedents dying annually.

2. *Revenue loss.*—Step-up results in a significant revenue loss. Under step-up, an estimated $20 billion in accrued appreciation passes untaxed annually. The income tax on this $20 billion is not just foregone in the year of a decedent's death. It is permanently and irrevocably forgiven.

3. *Economic distortions.*—Step-up also creates serious adverse economic effects. The opportunity entirely to avoid income tax on appreciated assets by holding those assets until death distorts capital mobility by inducing individuals to retain assets solely to obtain this benefit. The inducement to hold assets to avoid the payment of income tax is referred to as "lock-in."

[1] 57 T.C. 650 (1972), Aff'd 510 F.2d 479 (2d Cir. 1975). cert. denied 423 U.S. 827
[2] 69 T.C. 665 (1978)
[3] T.C.M. 1978-51
[4] 70 T.C. 584 (1978)
[5] 495 F.2d 1079 (6th Cir. 1979)
[6] "In Search of the Elusive Big Rich", *Fortune* Feb. 12, 1979, 12.

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It is almost impossible to quantify the amount of wealth that is locked in. This is because lock-in is a negative phenomenon. It occurs when sales otherwise dictated by sound investment strategies do not occur. Of course, the decision not to sell may involve other considerations which cannot be separated from tax-induced lock-in. Nonetheless, to the extent the income tax system can be said to cause lock-in, step-up is a major source of that lock-in. Those whose estate planning takes step-up into account, and plainly this includes many elderly taxpayers and most taxpayers with large accumulations of unrealized appreciation, will inevitably find their decision whether to hold or sell affected by this provision.

Congress in 1978 relied upon revenue from higher sales volume to justify increasing the capital gains exclusion to 60 percent. The lock-in effect of step-up will undermine the goal of the reduced capital gains rates enacted by the Revenue Act of 1978. The purpose of the reduced capital gains rate was to unlock capital in the form of unrealized appreciation in assets that were not being sold because of the allegedly excessive tax burden imposed on the sales proceeds. This goal will not be met if taxpayers have the opportunity to avoid tax entirely by holding appreciated property until death.

Lock-in can best be reduced by treating death as a recognition event. If unrealized appreciation were taxed at the current long-term capital gains rates, a significant amount of the lock-in effect would be eliminated.

As to lock-in, carryover basis is a second best approach. It somewhat reduces the lock-in effect for investors concerned with estate planning, since complete forgiveness is eliminated. However, if the property continues to appreciate in value, the capital gains tax would be greater when the heirs consider selling, and then their lock-in would be somewhat increased. Thus, lock-in would be decreased for some but increased for others. The net effect on aggregate lock-in cannot be determined fairly.

4. *Disparate basis treatment for lifetime gifts and accrued but unpaid income items.*— Carryover basis for property acquired by lifetime gift has been the law since 1921. Similar treatment has existed since 1942 even in the case of property passing at death that consists of compensation, pension benefits, and unpaid installment obligations from the disposition of property. Yet, most property acquired by gift at death received a new basis. Lifetime and deathtime transfers should be treated similarly for income tax basis purposes.

The shortcomings of forgiveness are not newly recognized

The case against forgiveness on the grounds of inequity, revenue loss, adverse economic effects, and structural inconsistency is overwhelming. It is not surprising that these deficiencies have long been recognized and that a number of responsible proposals to cure the problem were suggested prior to the 1976 Act.

In 1963, while proposing that the gain on the transfer of a decedent's assets at death be subject to income tax at that time, Secretary Dillon stated:

> The prospect of eventual tax-free transfer of accrued gains with a stepped-up basis equal to the new market value ... distorts investment choices and frequently results in complete immobility of investments of older persons. ... The reduction in capital gains rates alone would not effectively deal with the lock-in problem. Without this broader, more equal capital gains tax base, there would be no justification for lowering capital gains tax rates.[7]

While President Kennedy's 1963 proposal was not adopted, the House Ways and Means Committee did at one point tentatively adopt carryover basis as a solution.

The 1969 Treasury Department Tax Reform Studies and Proposals also included a proposal to subject to income taxation the appreciation in the value of assets transferred at death.[8] The proposal was addressed to the following deficiencies of step-up:

> [I]nequality in the income tax treatment of people who accumulate their estates out of currently taxable income as compared to those who accumulate estates by means of unrealized capital gains.

[7]See exhibit 19, 1963 Annual Report.

[8]U.S. Dept. of Treasury, Tax Reform Studies and Proposals, 81st Cong., 1st sess., 28, 42, 107–111, 331–340 (1969).

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> At least $15 billion a year of capital gains fall[ing] completely outside the income tax system.
>
> [U]ndesirable economic effects because of the resulting "lock-in" effect.[9]

By 1976, Congress was prepared to address the issue. Forgiveness was repealed and carryover basis was substituted, effective for estates of decedents dying after 1976. The reasons for change were:

> Present law [step-up] results in an unwarranted discrimination against those persons who sell their property prior to death as compared with those whose property is not sold until after death. Where a person sells appreciated property before death, the resulting gain is subject to the income tax. However, if the sale of the property can be postponed until after the owner's death, all of the appreciation occurring before death will not be subject to the income tax.
>
> This discrimination against sales occurring before death creates a substantial "lock-in" effect. Persons in their later years who might otherwise sell property are effectively prevented from doing so because they realize that the appreciation in that asset will be taxed as income if they sell before death, but will not be subject to income tax if they hold the asset until their death. The effect of this "lock-in" effect is often to distort allocation of capital between competing sources.[10]

A problem of substantial magnitude existed under step-up, the problem had long been recognized and it was resolved in an acceptable manner through the enactment of the carry-over basis concept. Technical problems with the statutory provisions that have surfaced since enactment should not obscure this achievement.

The arguments for step-up forgiveness

The 1976 repeal of step-up prompted a large volume of comment. It is important to examine carefully the substance of this comment to identify legitimate questions.

1. *Death is a "tax loophole."* —The assertion has been made that those who favor repeal of step-up view death as a tax loophole. The issue is whether property which passes at death should be treated the same as property which passes *inter vivos.* It is not true that the repeal of step-up discriminates against people who hold property until death. Deferral of taxation aside, it simply places those individuals on an equal income tax footing with those who have not accumulated wealth in the form of unrealized appreciation and held it until death.

2. *Repeal of step-up will result in a new tax.*—Some assert that the repeal of step-up constitutes a new tax. This is untrue. There is no new tax imposed if step-up is repealed; rather certain property on which deferred income tax was forgiven now becomes subject to that tax. This is not a semantic point. As the chairman of this subcommittee stated in a recent address before the New York State Bar Association, "tax laws should apply equally to all taxpayers." When they do not, they should be changed. Forgiveness results in taxpayers who have sold property before death being treated differently than those who did not. The result is unequal application of the laws.

3. *The expectancies of those who relied on step-up must be protected.* —It is alleged that the repeal of step-up dashed the expectations of those who relied on that provision in making investment decisions. The answer is real, and not imagined, difficulties regarding expectations that should be protected lies in appropriate transition rules. The original carryover basis provision in H.R. 14844 contained no transition relief. To protect legitimate expectations, the transition rule, known as the "fresh start" adjustment, was added by the conference committee. If that provision does not achieve its intended purpose, it is appropriate to reexamine it and make necesary modifications. But it is totally inappropriate to retain step-up forgiveness because the transition rule may require adjustment.

4. *Repeal of step-up results in tax on inflation gains only.* —Some assert that step-up should be retained because much of the appreciation that would be subject to tax

[9] Ibid. at 331.

[10] House Committee on Ways and Means Report, Estate and Gift Tax Reform Act of 1976, H. Rept. 94-1380, 94th Cong., 2d sess., 36-37 (1976).

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under an alternative system is attributable to inflation. The amount of appreciation involved in the gifts of property noted in the cases cited earlier demonstrate that this is not the case. There is no way that inflation can account for increases in value of that magnitude. But even if it were true, the simple example of A and B provides a total response. Each was equally affected by inflation and yet the heirs of each receive different amounts. While the effects of inflation are a matter to which the administration is devoting considerable attention, it is neutral in this context.

5. *Death is an inappropriate time to impose income tax.* —Some of the comment over repeal of step-up has as its core the notion that it is inappropriate to treat the involuntary event of death as an income tax recognition event. This argument does not lead to the conclusion the forgiveness is correct. Rather, if accepted, it would lead one to adopt carryover basis. This is because under a carryover basis system no income tax is imposed until an appreciated asset is sold. Moreover, the argument ignores the fact that death is one of the few times an accounting of wealth is made for tax purposes.

6. *Repeal of step-up is unnecessary because unrealized appreciation is subject to estate tax.* —As I noted earlier, some assert that it is not necessary to subject unrealized appreciation to income tax because that unrealized appreciation is included in the decedent's estate and is subject to estate tax. This argument is rebutted by the simple example of A and B, one of whom sold his assets before death and the other who did not.

It has been suggested that, to the extent the argument against step-up forgiveness involves concern over the revenue loss attributable to the $20 billion dollars of unrealized appreciation passing untaxed annually, the solution is simply to raise estate tax rates. However, there is nothing like the uniformity in the ratio of appreciable assets to estate size, between taxpayers having the same estate size, that would be required before consideration could be given to substituting an estate tax increase for repeal of step-up.

A simple increase in estate tax will not result in fairness for income tax purposes between estates of the same size.

If it is believed that carryover results in too great an overall tax burden, it would be fairer to lower estate tax rates for all estates than to forgive income tax liability. If the subcommittee desires, we would be happy to work with it to analyze this question. But the question of overall tax burden cannot be permitted to obscure the basic issue forgiveness raises: the equitable income tax treatment of those who have realized gain prior to death as opposed to those who have not.

7. *Carryover basis or subjecting unrealized appreciation to graduated income tax rates at death is regressive.*—The Committee may hear testimony that the 1976 carryover basis provision is regressive by estate size. A basis adjustment is made to account for the fact that estate tax has been paid on property that has been valued without taking into account the contingent income tax liability on unrealized appreciation. Because of this basis adjustment the increase in overall tax for a given amount of appreciation will decline as the size of the estate increases. This is said to be regressive.

It is, of course, true that for estates in the 70-percent bracket, forgiveness of income tax only lets the heirs keep 30 cents for each dollar of income tax that is avoided while in the 40-percent estate tax bracket the advantage of step-up forgiveness is 60 cents on the dollar. Carryover merely eliminates the advantage to the extent it exists. There is no more regressivity here than in the allowance of a deduction for administration expenses that is worth 70 cents on the dollar to a very large estate and nothing to a very small estate. Yet the deduction is necessary to measure the estate transferred. The adjustment simply assures that the estate tax applies to the correct transfer tax base, the gross estate less the amount of accrued income tax liability.

8. *Any system other than step-up cannot work because proof of basis problems are insurmountable.*—This subcommittee has previously received testimony and submissions to the effect that no system which relies upon the need to determine the basis of assets transferred at death can possibly work. The assertion is that either taxpayers do not keep adequate records of the acquisition cost of assets during their lives or if they do, those records somehow disappear at death.

This problem did not deter Congress when it first enacted the income tax. The basis of property held on March 1, 1913 was its value on that date or historical cost and the income tax system managed to work. The Canadians adopted a similar basis rule when

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they first treated gifts and deathtime transfers as recognition events. Their system has not posed significant basis determination questions. Both Canadian Government authorities and private practitioners inform us that the issue of proof of basis has not even been a matter of public discussion. Moreover, carryover of basis has not caused significant difficulties for property transferred by gift or items of income in respect of a decedent passing at death. These carryover provisions have existed since 1921 and 1942 respectively. Nonetheless, we understand that the American Bankers Association, and perhaps others, will submit a number of actual cases in which, during the period carryover basis appeared to be in effect, executors had difficulty determining the basis of assets. We look forward to examining this report so that we can determine independently the scope of this problem and suggest appropriate solutions.

Notwithstanding the data which may be submitted, several fundamental points are relevant. First is the necessity of recordkeeping to provide for the case of a lifetime sale or other disposition of property. Second is the question of the types of assets for which it is reasonable to assume taxpayers retain cost records. Third is the standard to which taxpayers who acquired assets prior to the effective date of any new system should be held. Once these three issues have been examined it is possible to design a system which takes into account legitimate recordkeeping problems.

Under our income tax system (and for gift tax reporting purposes), an individual who acquires property should retain cost basis information. That information will be relevant if that property is sold or given away. Even under step-up forgiveness, records were unnecessary only if a taxpayer knew with absolute certainty that the particular asset would be held until death. Since most taxpayers pay for assets they acquire, and all taxpayers are interested in reducing tax on sale, it is in their interest to retain or obtain cost records. Otherwise secondary evidence will be needed to establish some basis or the entire sale price will be taxable.

We believe most taxpayers recognize this and do retain cost records for most assets. Whether those records are readily accessible or in a form which could be understood by others is a different question and one to be examined in the context of transition relief. However, it is simply not true that the vast majority of taxpayers of this country fail to keep records as to the acquisition cost of the vast majority of assets they acquire, especially investment assets held by the wealthiest 2 percent of taxpayers.

The proposition that recordkeeping problems should control whether tax is imposed on an otherwise clearly taxable event would, if carried to its logical extreme, mean that only "easily measurable" income should be taxed. It also implies that the determination whether income is easily measurable rests entirely with the taxpayer. Thus, the taxpayer can, in his own discretion, control whether sufficient records exist to determine his income tax liability. If he fails to maintain records, income becomes hard to measure and hard-to-measure income is not subject to tax. Forgetfulness should not be blessed with forgiveness.

Records regarding the acquisition cost of closely held corporation stock may be difficult to find but should be capable of reconstruction. In the case of partnerships and subchapter S corporations past income tax returns will provide basis information. For those who are engaged in sole proprietorships, past income tax returns will show the basis of depreciable assets.

If acquisition cost records do not exist with regard to investment real estate, it is usually possible to recreate or estimate basis by a number of methods. For example, many deeds state the purchase price of real estate. Transfer tax stamps or local property tax assessments may also provide guidance. The basis of marketable securities can be estimated by reference to market quotations on or about the acquisition date.

We recognize, however, that recordkeeping problems do exist with regard to certain types of assets and that it is necessary to address these problems in designing appropriate relief. For example, many taxpayers may fail to retain records of the cost of items of tangible personal property such as furniture, clothing, collections of nominal value, and the like. Many taxpayers also fail to keep accurate records with regards to improvements to personal residences.

Problems with records for property acquired prior to the effective date of the repeal of step-up must be distinguished from problems which may occur thereafter. Congress must assume that any justification for failure to keep records disappears once taxpayers are on notice that assets acquired after the effective date are subject to the new statute.

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Step-up cannot be retained just because there are fears that taxpayers will not keep records.

Therefore, the recordkeeping problem the subcommittee should focus upon is that of basis information for assets acquired prior to the effective date of the repeal of step-up. Our experience under the income tax when originally enacted and the recent experience of the Canadians indicate that this should not be a serious problem. Moreover, the problems that do exist should be alleviated by the "fresh start" concept adopted in 1976.

Under this approach, the basis of property in the hands of an heir is the greater of historical cost or value on December 31, 1976. Two rules exist to determine value on December 31, 1976. If the property was a marketable security, the value is the market quotation. The December 31, 1976, value of all other property is determined by prorating appreciation from the date of acquisition to the date of death on a daily basis and adding to the acquisition cost that portion of the appreciation attributable to the holding period prior to December 31, 1976. However, under the 1976 rules, the fresh start adjustment is available only for purposes of determining gain. Thus, historical cost is also important because it is the only basis upon which a loss may be recognized.

Under this system of transition relief records play an important role. However, a few simple changes should resolve the record keeping problem for the vast majority of taxpayers. For example, consider the following. The present $10,000 personal and household effects exclusion would be increased to $50,000, property subject to the exclusion would be expanded to include tangible personal property which was a capital asset in the hands of the taxpayer, and excluded assets would be determined in ascending order of value as reported on the decedent's estate tax return. The basis of property acquired prior to the effective date would continue to be the greater of acquisition cost or the fresh start value but the fresh start value would be available for determining both gain and loss. Fresh start value for marketable securities would be the market quotation on the relevant valuation date. Certain classes of property the value of which will not increase after the valuation date (such as notes or selected types of preferred stock) would be treated like marketable securities for this purpose. All other property would have the fresh start value determined by use of a generous formula starting with estate tax value and assuming annual appreciation of 6 percent, subject to a minimum in any case of 25 percent of estate tax value. That is, the fresh start value would be determined by dividing estate tax value by a number from a table which would contain the appropriate discount date. The discount back formula would replace the present time apportionment method.

In this system, historical cost is relevant only if it exceeds fresh start value. It is not needed to determine fresh start value as is presently the case.

It is true that historical cost may exceed fresh start value and executors may still feel pressured to find historical cost. In the case of almost all property, however, it should be possible for the executor to make an educated judgment as to the likelihood of historical cost exceeding fresh start value. Where that is probable, we also believe satisfactory information to recreate basis will exist. However, if the Congress feels that finding historical cost, even after taking into account this generous fresh start relief, is still a burden it could simply say that the basis of assets acquired prior to the effective date will be equal to the fresh start value.

A solution such as that set forth above should eliminate proof of basis problems for the bulk of the examples which will be presented to the subcommittee for assets acquired prior to the effective date. As for assets acquired after the effective date, taxpayers are put on notice of the need to retain basis records. Special relief is provided for household effects and the like.

In short, we believe the proof of basis issue is a red herring. We agree with the special tax counsel to the trust division of the American Bankers Association, Richard B. Covey, who stated in a recent article that objections to carryover basis on the ground that proof of basis problems were so severe as to merit a return to step-up were "premature, at least until a reasonable trial period has passed."[11]

9. *Carryover basis delays the probate of estates, inordinately increases the cost of estate administration and presents irreconcilable fiduciary conflicts.*—The allegation is

[11]Covey and Hastings, "Cleaning up Carryover Basis," 31, The Tax Lawyer, 615, 695 (1978).

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made that carryover basis, solely by introducing a new concept to be taken into account during estate administration, frustrates efforts of the probate bar to simplify the administration of estates. It is true that any departure from step-up introduces additional complexity. However, if the proposals we suggest are adopted this complexity will not exist for 98 percent of the estates coming into existence annually. The question is whether carryover basis unduly affects and delays administration of the estates of the remaining 2 percent.

If our proposals are adopted, much of the anticipated difficulty and cost of administration of carryover basis is eliminated. The aggregate cost of compliance will be insignificant compared to the revenue it generates and the increased income tax equity it produces.

It is also alleged that carryover basis improperly intrudes in estate administration by creating an entirely new set of considerations to be taken into account in distributing assets to various beneficiaries. While by no means certain under applicable state law, it is possible that a fiduciary may have to take income tax basis into account in making distributions.

If this is an assertion that fiduciaries are incapable of administering estates when they must take tax consequences into account, it is a curious one. Estate planning and administration is replete with tax considerations. The tax literature abounds with learned discussions of various minimization techniques. Entire books have been written on subjects such as the marital deduction. Law schools devote entire courses to estate planning and administration. Many wealthy taxpayers, who also happen to be those who would be affected by the repeal of step-up, often pay substantial legal fees to tailor estate plans to minimize taxation.

If this argument is premised on the fact that property with bases different from estate tax value cannot be dealt with by fiduciaries, it is also rather curious. The real world is complicated for those administering large estates. Fiduciaries must already make choices which have both tax consequences and affect the net amounts received by beneficiaries and they are not clamoring to have these elections eliminated. For example, fiduciaries must decide whether to file a joint or separate income tax return for the year of the decedent's death; whether to claim expenses as estate or income tax deductions; whether to elect the alternate valuation date; whether to elect special use valuation; whether to elect to pay estate tax in installments; whether to distribute property in cash or in kind; whether to receive retirement benefits in other than a lump sum; the choice of a fiscal year; whether to accumulate or distribute estate income; which assets to sell and how to reinvest the sales proceeds; when to settle claims and when to terminate administration. Carryover basis considerations do not materially add to these decisions. Indeed, in the more sophisticated estate plans, decisions with regard to the administration of formula marital deduction clauses make the alleged carryover basis problems pale in significance.

The choices

I have previously stated that the administration is committed to the principle that income tax on appreciation in assets held at death should not be forgiven. The choices as to how to tax this appreciation are two: Treat death as a recognition event for income tax purposes or provide that the decedent's basis carries over to his estate and heirs.

There are a number of principles that should be applied in making this choice. First, the system should be as simple as possible consistent with the principle that similarly situated taxpayers should be treated similarly. Second, the system should intrude as little as possible in the estate administration process. Third, where the system may produce hardships such as liquidity problems, those issues should be identified and dealt with in a fair manner. Fourth, the treatment of lifetime and deathtime transfers should be the same.

Any system without step-up forgiveness is more complicated than a system with step-up. There is no question that forgiveness is simple. There is no need to determine basis and so long as an individual does not sell an asset, inaccurate or nonexistent records present no problems.

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However, this argument proves too much. Nontaxation is always the simplest system and an argument as to simplicity can be made with regard to almost any taxing provision, including deductions or credits.

There is much to be said in favor of treating the transfer of property at death as an income tax recognition event. It achieves parity between taxpayers who sold property before death and those who did not, with those who held assets until death still retaining the advantage of tax deferral on unrealized appreciation. Such a system could be more simple than carryover basis because accounts would finally be settled at death. Alleged fiduciary problems encountered in taking into account potential income tax liability in connection with the distribution of property to various beneficiaries would be eliminated. The distortions of lock-in would be lessened. Finally, basic adjustments to account for estate tax attributable to unrealized appreciation would be eliminated.

The Treasury Department believes that treating a transfer at death as a recognition event is an entirely acceptable solution to the step-up problem. We have devoted considerable time over the last several months on the development of alternatives to implement such a system, including an examination of the two forms of "Additional Estate Tax" until recently favored by the American Bankers Association. If the subcommittee indicates an interest in pursuing this course, we would be willing to supply these materials when we have completed our work on them.

I have also indicated that, in concept, carryover basis represents an acceptable solution to the forgiveness problem. However, we agree experience has shown that the 1976 Act statutory structure could be improved.

Recognizing this, Treasury has made a major effort to meet with interested professional groups and individuals to learn of their specific concerns and their suggestions for change. We have received valuable assistance from the American Institute of Certified Public Accountants, the Trusts and Estates Law Section of the New York State Bar Association and individual members of the Special Carryover Basis Committee of the Tax Section of the American Bar Association, to name just a few. This hearing, we hope, will provide another opportunity for the public to suggest to the Subcommittee and Treasury their proposals for modifications.

At this time I would like to examine the complaints regarding the operation of the 1976 carryover basis provision that have been registered with the Subcommittee in prior hearings, and propose solutions to them. I shall divide my discussion of these problems into three areas, the basic statutory provision, the transition relief afforded by the fresh start adjustment, and liquidity issues.

1. The basic statutory provision

a. *The provision is overbroad because it applies to the estates of many decedents who are not required to file estate tax returns.* We recommend that, in general, carryover basis would apply only to those estates for which estate tax returns are required. The basis for assets held by estates not required to file Federal estate tax returns would be determined under step-up. Executors of nonfiling estates would not, therefore, be concerned with the basis of any property included in the estate except, as under present law, items of income in respect to the decedent. This change would eliminate approximately 98 percent of decedents dying annually from the operation of carryover basis.

It has been alleged that this change is purely a political expedient and that subjecting only 2 percent of decedent's estates to carryover basis violates the principle that the tax laws should apply equally to all taxpayers. Carryover basis will indeed apply to a small segment of decedents dying annually, but that small segment is the segment that owns more than 75 percent of all appreciated assets.

An increase in the minimum basis from $60,000 to $175,000 necessarily accompanies this proposal. Thus, the minimum basis assures that equality of tax benefit is given to large estates as well as small. Moreover, we believe the allocation of the minimum basis should be changed so that it does not depend upon a formula. Rather, the minimum basis would be allocated in the discretion of the executor first to capital assets and then, if any minimum basis remains, to assets which would produce ordinary income in whole or part when sold by the estate or heir.

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The change in the allocation method will provide some measure of liquidity relief in those instances where the executor must sell assets to meet estate liabilities. It also eliminates the necessity to recompute the allocation of the entire minimum basis if there is an audit adjustment to the value of the property in the estate.

Minimum basis would be calculated prior to the death tax basis adjustment. This reverses the order of computation under the present provision. The minimum basis will therefore constitute a floor to which the death tax adjustment can be added rather than a cap as is presently the case.

b. *The amount of the "personal and household effects" exclusion is too small and the term is ambiguous.* The present exclusion would be increased to $50,000. To eliminate definitional ambiguity and relieve executors of the task of choosing excluded assets, the exclusion would be available to all items of tangible personal property that were section 1221 capital assets of the decedent. Assets subject to the exclusion would be selected in ascending order of value as shown on the decedent's estate tax return. In addition to eliminating questions of fiduciary choice, this expanded exclusion will solve the proof of basis problem for many of those who own collections.

c. *The present death tax adjustments are unduly complicated, are computed by reference to an incorrect rate and require recomputation for all assets if the value of one asset is changed on audit.* A simplified single death tax adjustment would replace the three separate but interdependent adjustments required under present law. A percentage number would be taken from the estate tax rate table and applied to each item of appreciated property subject to estate tax. The percentage to be applied would be the highest tax rate to which the estate is subject before any credits are applied, except that if an estate does not have at least $50,000 of property subject to tax in that bracket the next lower rate would apply.

To illustrate, a taxable estate of $400,000 will be in the 34-percent bracket. Each item of appreciated property used to fund a taxable bequest would receive a basis increase equal to 34 percent of the appreciation in that property. The total Federal estate tax payable on a $400,000 estate, after subtracting the $47,000 unified credit, is $74,800, or approximately 19 percent of the total estate. Yet, in this case, the adjustment would be 34 percent. Under the 1976 Act provision, the 19-percent average tax rate would have been used.

Where an estate is nontaxable because of the unified credit, an adjustment, based upon the estate tax rate schedule would nonetheless be allowed. The allowance of an adjustment in this case permits an ample adjustment for any state death taxes.

No adjustment would be made where the decedent's estate was not required to file a Federal estate tax return. In that case step-up will apply.

The move to a single death tax adjustment, computed at the highest marginal estate tax rate, has been uniformly applauded as a major simplification by all with whom we have consulted. Indeed, Mr. Covey, has commented:

> ...The Treasury approach ... is commendable and a major step towards simplifying the complex and defective section 1023(c) and (e) adjustments. When combined with the proposed $175,000 minimum basis and with a computation of minimum basis before rather than after the adjustment for estate tax on appreciation, a fair overall result is achieved even though no direct adjustment is given for state death tax. In effect an adjustment is given for state and foreign death taxes in amounts equal to the section 2011 or 2014 (or treaty) credits because the marginal federal estate tax rate is a precredit rate.[12]

The proposal has been criticized, however, on the ground that it does not permit a basis adjustment for State death taxes that exceed the amount allowed as a Federal credit. It is true that State death taxes in excess of the Federal credit do not result in an additional basis increase. However, one would question whether it is appropriate to give a Federal tax adjustment for State taxes in excess of the credit amount. Rather, if a State's death taxes are too high, the problem should be resolved by the State. Moreover, the adjustment is computed at the highest applicable marginal Federal estate tax rate, and therefore may result in an overcompensation because much of the estate has been subject to tax at rates less than the highest marginal rate. In addition,

[12]Covey and Hastings, "Cleaning Up Carryover Basis", 31, The Tax Lawyer, 615, 647 (1978).

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the adjustment is available without regard to the amount of depreciated property in the estate.

The most recent commentary of the American Bankers Association makes much of the failure to adjust for State death taxes. However, Mr. Covey makes the argument in opposition eloquently when he states, using New York as an example, that:

> The understatement of the basis increase for the New York estate tax on appreciation will most frequently occur when all of the appreciation is taxed in only one rate bracket for federal purposes. To illustrate, for a taxable estate in excess of $10 million with all appreciation taxed in the top rate bracket, the basis increase on the Treasury approach is $70 for each $100 of appreciation while under an exact method the increase would be $75 for each $100 of appreciation. If, however, the appreciation was taxed in two or more federal rate brackets, the federal basis increase under the Treasury approach would be overstated when compared with the result of an exact method. This point can be seen by taking estates of various sizes which are all appreciation. *In such a case, the Treasury approach would exceed the basis increase under an exact method until the taxable estate exceeds $60,000,000.* (Emphasis added).[13]

Mr. Covey goes on to state:

> Major simplification would be achieved under the Treasury approach because the basis increase would in most cases not be "suspended." A change in the increase would be required only if as a result of the audit of the federal estate tax return the estate is moved up in a rate bracket.[14]

While this adjustment is generous in most cases, this generosity does not significantly affect horizontal equity, achieves a fair result and is consistent with the principle that complexity should be avoided where it is possible to achieve a comparable result in a simple manner.

d. *It is unnecessarily time consuming to require the death tax adjustment to be computed separately for every asset included in the decedent's estate.* Since the death tax adjustment is a single percentage, it is simple. Moreover, the executor would be permitted to elect to average the basis of similar items of property acquired at different times. For example, the basis of mutual fund dividend reinvestment shares or shares of stock of the same corporation acquired at different times could, at the executor's election, be averaged. The simplified single death tax adjustment would then be applied to the average basis rather than the actual basis of each share. This proposal would also simplify executors' decisions regarding the distribution of appreciated assets. All similar property would have the same basis and inherent gain would be the same.

e. *Special rules are needed for personal residences.* We propose two changes. First, if unused, the $100,000 personal residence gain exclusion would be available to the decedent's executor on an elective basis as a positive basis adjustment, without regard to the decedent's age but with the consent of a surviving spouse required. This would coordinate the 1978 Revenue Act changes with the carryover basis system. Second, an annual addition to basis (for example $250), would be permitted for personal residences acquired after the effective date of the statute to account for improvements, unless a larger amount could be substantiated in any year. This would mitigate the recordkeeping problem for minor home expenditures.

f. *The present reporting requirements are unduly burdensome.* If the foregoing proposals are adopted, basis information reporting would be required only from executors of the less than 2 percent of estates subject to carryover basis. Penalties would be assessed pursuant to a negligence standard only.

g. *The basis of carryover basis property remains uncertain until that property is disposed of in a transaction in which basis becomes relevant.* A procedure would be created pursuant to which executors could achieve a final determination of basis, binding upon both the executor and the Internal Revenue Service, at the time of audit of the decedent's estate tax return. A number of the groups with whom we have

[13] *Ibid.*, 647-648.

[14] *Ibid.*, 648.

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consulted have suggested that such a procedure is essential to resolve basis uncertainties and simplify the long-term administration of carryover basis.

2. Transition relief

a. *The fresh start rule applicable to nonmarketable property poses insurmountable proof of basis problems.* This question was addressed earlier. To reiterate, the discount back rule of the Revenue Act of 1978 would be applied at a rate of 6 percent to determine the fresh start basis for all property held on December 31, 1976, other than marketable bonds and securities. The application of this formula could in no event result in a basis less than 25 percent of estate tax value. The present formula which apportions appreciation ratably on a day-to-day basis would be abandoned.

Historical cost would be important only if it exceeded the fresh start value. If this is deemed to impose undue burdens on executors, the discount back formula could be the sole method.

b. *The fresh start adjustment unfairly discriminates against nonmarketable property, because its fresh start basis can never exceed estate tax value.* It is true that the fresh start value of nonmarketable property cannot exceed estate tax value.

One solution is to provide a "national appraisal date" and permit the appraised value of property on that date to be its fresh start value. Congress specifically rejected this alternative in 1976 and we think it was wise so to do. Even if one believes in the veracity of appraisals, it is questionable whether all taxpayers should be put to the expense of obtaining such appraisals when it is not clear that the appraised property will be held until death. Moreover, in the real world, even contemporaneous appraisals are the subject of substantial dispute. It is, therefore, reasonable to anticipate administrative problems when the validity of an appraisal is examined many years in the future. These facts lead to the conclusion that the appraisal technique is not appropriate. The discount back formula is a reasonable alternative.

Certain types of nonmarketable property would be treated as if they were marketable securities for purposes of this fresh start rule. There are assets, the value of which will not change substantially from the fresh start date to the date of death. It is unfair to subject these assets to fresh start value determination under a discount back formula. Therefore, we propose that nonconvertible, nonparticipating preferred stock be given fresh start value equal to its redemption price on the fresh start date.

In addition, the Secretary would be granted regulatory authority to devise alternatives to the discount back formula for assets which will not substantially appreciate in value after the fresh start date such as nonmarketable notes, and assets the value of which could be readily ascertained as of December 31, 1976, by a method other than appraisal. An example of the latter is property subject, on the fresh start date, to a binding buy-sell agreement that has the effect of fixing estate tax value. The fresh start value would be determined by reference to the formula set forth in the agreement.

c. *The fresh start basis should be available for purposes of both gain and loss.* Treasury agrees. This change would eliminate the need to retain records of separate bases for "fresh start" property.

d. *The fresh start adjustment should be calculated by reference to estate tax value.* Again, Treasury agrees. Executors would not be required to establish date of death value as a computation base where the estate tax alternate valuation date is elected.

3. Liquidity issues

Carryover basis itself does not cause liquidity problems. No tax is due in a carryover basis system until carryover basis property is sold. No family farm faces a tax liability from carryover basis until the farmland is sold. If liquidity problems exist, they arise because of the estate tax.

A large portion of the appreciated property held by estates is comprised of marketable securities and investment real estate. In the case of marketable securities there can be no liquidity problem. In the case of investment real estate, the estate tax will be imposed on the value of the property net of indebtedness. To the extent investment real estate is subject to estate tax, the net equity in the property should be sufficient to secure a loan sufficient to pay the estate tax.

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Problems may exist where the investment property does not generate sufficient income to service a loan. We would be sympathetic to proposals to provide additional liquidity relief in these situations where there is demonstrated need.

Closely held business interests and farms, which represent only 7 percent of the value of assets reported on estate tax returns, pose a somewhat different problem. In the case of farms, special use valuation significantly reduces includable value for estate tax purposes. Liberal estate tax deferral provisions provide an opportunity to spread the payment of estate tax over 10 or 15 years for qualifying farms and small businesses. Finally, section 303 provides an opportunity to have closely held stock redeemed at reduced capital gains rates. The combination of these provisions provides a significant measure of relief. However, we are willing to explore additional liquidity relief solutions for farms and closely held businesses that will reduce or defer the payment of income tax on assets sold to pay estate tax.

Conclusion

The basic issue before this Subcommittee is the fairness of an income tax system which forgives income tax on appreciated assets passing at death. Forgiveness is unsound income tax policy. Those who would return to step-up should justify that step. They cannot be allowed to use technical complexity as a rationale. Technical problems can be solved.

It is the administration's firm position that unrealized appreciation in property held at death cannot be permttted to escape income taxation. Either carryover basis or treating death as an income tax recognition event is acceptable.

We look forward to hearing the testimony of those individuals who will appear before you and to reading the written submissions of the others. We hope you will permit us to respond for the record to the testimony you will hear today and next week. To that end I ask that you hold the hearing record open for an additional 2 weeks to enable us to prepare that response.

Exhibit 40.—Statement of Deputy Assistant Secretary Sunley, March 22, 1979, before the Subcommittee on Oversight of the House Ways and Means Committee, on the investment tax credit

I am pleased to appear before you today to discuss the investment tax credit. This credit, which will reduce Federal receipts by over $15 billion in fiscal year 1980, is one of the largest tax expenditures of the Federal Government. It is, therefore, important that Congress periodically reexamine its impact on the economy and consider how its efficiency and fairness might be improved. I am not today going to recommend changes in the credit. A major thrust of my testimony is that the credit should not be turned on and off as a countercyclical policy but should be viewed as a stable feature of our tax law. I will, however, discuss some of the pros and cons of making several changes in the structure of the credit.

The investment credit is equal to 10 percent of qualified investment. Assets eligible for the investment credit include most machinery and equipment, but generally do not include structures. Eligible equipment is restricted to depreciable property with a useful life of 3 years or more.

The investment credit can be regarded as similar to a cash grant to purchasers of certain capital equipment, with certain peculiar rules related to the fact that it is cleared—that is, paid and distributed—through the tax system. The credit, however, differs in significant ways from an across-the-board 10-percent subsidy for new machinery and equipment.

- The credit is not refundable. If tax liability exceeds $25,000, the credit is limited to $25,000 plus 60 percent of tax liability in excess of $25,000. In 1982, after a transition period, the tax liability limitation will be increased to 90 percent. Prior to 1978, the credit beyond the first $25,000 was limited to 50 percent of tax liability. Unused credits may be carried back 3 years against prior tax liability and carried over for 7 years. Treasury estimates that credits claimed by corporations were about 68 percent of the tentative credits earned

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in any year when the 50-percent limit was in effect. The carryback and carryover provisions enabled about 85 percent of these tentative credits ultimately to be used. The 90-percent limit will increase to about 78 percent the fraction of credits claimed by corporations in the year they are earned.

- The credit is reduced for short-lived assets. Investment qualified for the credit is two-thirds of the cost of the asset if the useful life is at least 5 but less than 7 years and is one-third of the cost of the asset if the useful life is at least 3 but less than 5 years. On the average, the short-lived property rules reduce the allowable amount of the investment credit by 10 to 15 percent.
- When an asset is purchased, its expected life is used in determining the fraction of the asset cost for the credit. Upon disposition of the asset, if actual life is less than the expected useful life any excess investment credits claimed in a prior year are recaptured.
- The investment credit claimed does not reduce the cost basis used for depreciation. Even though the Government has, in effect, paid for 10 percent of the investment, 100 percent of the purchase price may be depreciated. The tax savings from this additional depreciation to a corporation in the 46-percent bracket is equivalent, for an asset of average life (12 years) to a 29-percent increase in the investment credit from 10 percent to 12.9 percent.

In evaluating the investment credit, some fundamental questions should be asked:

- Should we subsidize the purchase of machinery and equipment?
- Does the investment credit substantially increase investment in machinery and equipment? Does it increase total investment?
- Are there more effective ways of providing the same subsidy?
- Does the investment credit create unintended or undesirable side effects? Some that have been mentioned are: (1) discrimination against small firms and rapidly growing firms because credit is limited to 90 percent of tax liability, (2) encouragement of leasing, (3) discrimination among investments with different useful lives, and (4) increased opportunities for tax shelters.

The main purpose of the investment credit is to increase permanently the fraction of GNP allocated to savings and investment. To the extent it accomplishes this, it increases the rate of growth immediately, and provides a permanent increase in the amount of capital per worker, productivity, and real wages.

A second objective of the investment credit is to increase the proportion of total private savings allocated to investment in machinery and equipment. The credit stimulates capital formation in major manufacturing industries and also furthers innovation by accelerating the installation of new capital embodying the most recent technological advances. The credit has not been extended to most real estate since this industry benefits from other significant tax preferences.

Impact on investment

Any evaluation of the investment credit must consider how much it promotes these two objectives: Increasing the overall rate of capital formation, and allocating a larger share of national savings to investment in machinery and equipment.

The investment credit operates by providing an incentive for firms to purchase new machinery and equipment. To finance these increased purchases, firms must acquire more funds, either through higher retained earnings, new equity issues, or increased borrowing. As firms bid for the scarce supply of savings generated in the economy, the return on savings is increased. This encourages an increased flow of savings at any level of income. In order for the rate of capital formation to increase, these increased savings must be forthcoming to match the increase in investment demand.

The net effect on total investment, therefore, depends not only on the stimulus to investment demand but also on the responsiveness of private savings to increased rates of return. It also matters how the revenue cost of the credit is financed, by the Federal Government. If it is financed by a larger deficit, the resulting increase in Government borrowing will reduce savings elsewhere; if it is financed by increases in taxes on labor income or consumption or by a reduction in Government spending on current period

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goods and services, there will be an increase in savings at the expense of current consumption.

Economic theory strongly supports a conclusion that the investment credit increases the rate of capital formation. However, the size of its impact relative to the revenue loss is in dispute. A review of econometric studies reveals considerable uncertainty about the impact of the investment credit and of other capital formation incentives on total savings and investment.

A number of econometric studies have estimated the impact of the investment credit, and of other tax incentives to capital formation, on investment. The findings of this research are highly varied because investigators have used different methods and assumptions.

Early research by Professors Robert Hall and Dale Jorgenson found that enactment of the investment tax credit in 1962 had a powerful effect on investment demand in the 1960's. The Hall and Jorgenson study focused on the role of the credit in increasing the demand for capital by lowering the price of capital services. Their theoretical model used a formulation of the demand for capital that assumed that a 10-percent reduction in the price of capital services, which could be achieved by a 10-percent refundable investment credit with a basis adjustment for depreciation, would increase in the long run the stock of capital demanded by 10 percent. Subsequent investigators used more flexible assumptions that allowed them to estimate the impact of the investment credit on the longrun demand for capital and that, to varying degrees, stressed other factors as determinants of investment such as corporate cash flow, expected future sales, and financial market variables. The estimated longrun impact of the investment credit on the demand for capital in these studies is highly variable. Professor Charles Bischoff, for example, estimated that a 10-percent reduction in the cost of capital would also raise the demand for capital by 10 percent, while Professor Robert Coen estimated that such a reduction in the cost of capital would increase the demand for capital by only 3 percent. Professor Robert Eisner's estimates of the impact on capital formation of the investment credit are even smaller.

Studies that focus on investment demand alone ignore an important potential constraint on the effects of the investment credit: the need for additional private savings to finance increased investment. If more private savings are forthcoming only if the after-tax yield from savings increases, then the resulting increase in interest rates will choke off some of the potential increase in investment demand. Professors Paul Taubman and Terence Wales have explored this issue, estimating that the need for higher interest rates to bring forth additional savings reduces the impact of the investment credit to about one-fourth of the estimated increase in demand for capital. This issue—the extent to which additional savings will be forthcoming to finance an increased demand for capital—remains an important source of differences in estimating the impact of capital formation incentives such as the investment credit.

While the effect on total capital formation of the investment credit is uncertain, available evidence shows that the sectoral impact is strong. By changing the *relative rewards* to different uses of savings, the investment credit increases the share of total investment allocated to qualified machinery and equipment and reduces the share allocated to other sectors, especially real estate. The relatively strong impact of the credit on investment in machinery and equipment has been shown in many studies, beginning with the original paper by Professors Hall and Jorgenson. In a 1971 paper, Henry Aaron, Frank Russek, and Neil Singer provided evidence from econometric simulations that removal of the investment credit in 1969 caused a significant shift of new investment from machinery and equipment to real estate, more than offsetting the effects of tightening real estate depreciation and recapture rules. Their findings are consistent with what we would expect in an economy where investors are seeking the highest after-tax return on their dollars and efficient financial markets facilitate movements of funds between different sectors.

Countercyclical policy

One frequently used argument that is not an appropriate goal for the investment credit is shortrun economic stimulation. It is true that an increase in the investment credit by itself increases the demand for investment and therefore could increase

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employment and promote recovery at a time when the economy is depressed. However, it should be recognized that any increase in the deficit can increase total demand in the economy and, if there is unemployment, create additional jobs. If fiscal stimulus is needed, individual tax cuts may well be superior to business tax cuts or changes in the investment credit or other expenditure programs because the individual tax cuts are probably translated into additional spending with shorter lags and less leakage into savings.

Moreover, changes in the investment credit are a very poor tool of countercyclical policy. Econometric studies have found a strong effect on aggregate demand from the investment credit. However, because capital spending plans are frequently made well in advance of actual expenditures and are difficult to change once set in motion, the investment credit impacts with a very long time lag. In the past, changes in the credit have often been poorly timed. The credit was temporarily suspended in 1966—just before the 1966-67 pause in economic growth. It was restored in 1967—just prior to the inflationary boom of the late 1960's. It was removed in 1969—just before the 1970 recession. It was restored again in 1971—shortly preceding the overheating of the economy in 1972 and 1973. In all of these cases, the change in the investment credit had its strongest effect on aggregate demand at the wrong time; it was expansionary during an upswing and contractionary during a slump. Of course, this need not always result from a change in the credit, but the long-time lag between enactment of a change and its effect on investment demand make the investment tax credit an imprecise and uncertain tool of countercyclical policy.

Also, changes in the credit raise problems of determining appropriate transitional rules. For example, when the credit is suspended or reinstated, should the credit remain available for machinery and equipment placed in service before the effective date or to machinery and equipment ordered before the effective date? In the past, determination of how new rules should apply has been different for suspension of the credit than for reinstatement. When the credit was repealed in 1969, taxpayers could still receive credit for eligible property subject to a binding commitment before the change was first proposed by the administration, as long as the actual delivery of the property occurred before the end of 1975. In contrast, the restoration of the credit in 1971 was made effective for property acquired or completed after the announcement date, August 15, 1971, or for property on which construction was begun or an order placed between March 31, 1971, and August 15, 1971. Further changes in the credit would require additional detailed rules relating timing of different stages of the acquisition process.

In summary, changes in the investment credit rate should not be considered in terms of shortrun stabilization objectives, but for its longrun effect on capital formation and on promotion of the best use of available private savings. It is worthwhile for Congress to review periodically the effectiveness of the credit in achieving these longrun objectives; future changes in the investment credit should be based on these considerations and not, as has sometimes occurred in the past, on shortrun economic forecasts.

Structural issues

Introduction.—Having reviewed the reasons for subsidizing the purchase of machinery and equipment by private firms, I now want to turn to the consequences of using the tax system as the mechanism for paying the subsidy, and what structural changes in the credit might be considered.

It is useful first to consider the simplest form of a subsidy to machinery and equipment: a direct grant program. Congress could encourage the purchase of machinery and equipment by allocating funds to the Department of Commerce, which would make payments to firms equal to 10 percent of the value of any qualified equipment purchased, or placed on order, after a specified effective date. Commerce would do this without regard to the tax posture of the recipient. If this type of subsidy were enacted, the normal method of tax treatment would be to regard the grant as a Government contribution to capital. The recipient's depreciable basis would not include the Government's contribution. The subsidy rate could be adjusted to make this type of cash grant program provide the same total subsidy to business firms as the

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investment credit. However, the distribution among firms of benefits received would be different from under current law. Firms that currently are not able to make full use of the credit or that invest heavily in short-lived property would be net gainers.

The investment tax credit could be altered to conform exactly to this direct subsidy program. This equivalence could be achieved by making the investment credit refundable, requiring a downward basis adjustment for the amount of credit received, and repealing the short-lived property rules. The only major difference between this type of investment credit and a direct expenditure program is that the tax credit would be under the jurisdiction of the congressional tax committees rather than appropriation and authorization committees and would not appear in the budget of any agency. Thus, with a tax credit, total Federal expenditures appear to be smaller. However, the effect on the deficit and on the amount of incentive provided for investment in machinery and equipment would be the same as an equivalent direct subsidy program.

This comparison illustrates that the present credit can be viewed as a direct expenditure program which is distributed through the income tax system, and which has some peculiar features because the income tax system is used. These special features create complexities in administration, anomalies for tax policy, and some unintended side effects. For this reason, their rationale and consequences deserve examination.

Nonrefundability.—The most important of these provisions is the nonrefundability of the credit and its limit to 90 percent of all tax liability in excess of $25,000. This provision is important not only for its direct effects, but because it creates a need for other provisions—the carryover and carryback rules and the inclusion of the credit in the depreciable basis—that would not be likely features of an expenditure program to promote investment.

There are two rationales for nonrefundability of the investment credit—one cosmetic and one substantive. The cosmetic reason is that, without the tax liability limit, it would appear that some large corporations are paying no tax or, in some cases, negative taxes. This issue of providing special tax relief for corporations would not arise if direct subsidies were used. Data on farm subsidy payments, for example, are not used to show that wealthy farmers pay no tax, and people do not consider linking eligibility to receive farm subsidies to a farmer's tax liability.

The substantive justification for the tax liability limitation relates to the numerous other subsidies being cleared through the tax system. These other tax subsidies should be taken into account. An example, as noted before, is offsetting the highly favorable tax treatment of real estate by restricting the investment credit to machinery and equipment. Restricting the credit by tax liability tends to limit its availability to other sectors receiving other tax subsidies—for example, mining—and thus tends to even out the total level of subsidies distributed in connection with any particular kind of activity. But the leveling out effect is haphazard because it depends in each case upon the mix of business in a particular company. As a result, it may encourage business combinations and mergers that are otherwise undesirable.

The denial of a portion of the investment tax credit to firms with low tax liability may have adverse consequences. Low tax liability is not necessarily the result of an abundance of tax subsidies. Companies experiencing temporary losses, companies making large expansions in capacity, and companies generally experiencing rapid growth frequently may not have sufficient tax liability to claim the full credit in the current period even though the income that will be earned from current period investment will generate high tax liability in the future. There is no reason to limit or deny the credit received by these companies.

The adverse consequences of nonrefundability are mitigated to some extent by provisions for the carryback and carryover of excess credits. In addition, firms with low current-period tax liability can lease machinery and equipment from firms with sufficient tax liability to utilize fully the investment credit. By charging lower rental payments the benefits of the investment credit may be passed through by the lessor to the lessee. The lessor, however, usually has to be paid a "commission," and this commission represents an economic cost. There is no particular reason why the tax law should encourage leasing transactions where private parties, not influenced by tax considerations, would not consider leasing a convenient and low cost method of financing assets.

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Carryback and carryover rules.—Provisions allowing tentative investment credits to be carried back 3 years and carried forward 7 years to offset past and future taxes mitigate the most severe consequences of nonrefundability by permitting new and growing firms and firms with temporarily depressed earnings to use the credit. But they are not complete remedies for those consequences because a credit received today is worth substantially more than one which will not be received until 7 years from today. Equally seriously, these provisions, increase the complexity of the law. Their most serious consequence is to make it much more difficult to write a simple law—however desirable—which would exclude the credit from depreciable basis. Because of the tax liability limitations on the credit, even with carryovers we do not generally know if and when the credit will be used. Therefore, a basis adjustment for depreciation would necessitate recomputing the depreciable basis when credits expire at the end of the carryover period. This type of computation is possible, but would severely complicate depreciation accounting.

Basis adjustment for depreciation.—Normally, firms would not be permitted to depreciate against taxable income the value of a cash subsidy received from the Government. However, under present law, the tax credit is included in the basis for tax depreciation even though it represents the portion of the asset's cost paid for by the Government, not the firm.

Including the credit in allowable depreciation raises the effective rate of investment credit by providing firms with extra tax deductions. In effect, the benefit of a $100 investment credit received by a taxpayer who purchases a $1,000 machine can be viewed as divided into two pieces. The first piece—the credit itself—reduces the cost of the asset by 10 percent for all taxpayers. The second piece is the $100 of additional tax depreciation in excess of the taxpayers' investment over the life of the asset. This piece is worth more to taxpayers in high tax brackets and is more valuable for short-lived assets because the benefits of tax depreciation for those assets are received sooner.

Because the extra depreciation is worth more to high bracket taxpayers, such taxpayers receive more encouragement to invest in qualified machinery and equipment than low bracket taxpayers. As in other situations where income is improperly measured, encouragement is provided for tax shelter formation. One way this has been manifested in the past is through leasing transactions that enable high bracket individual investors not actually using the qualified equipment to benefit from the credit. However, a 1971 provision limiting investment credits available to noncorporate lessors has substantially curbed this source of tax shelter abuse.

Reduction of credit for short-lived assets.—The extra benefit to short-lived assets provided by additional depreciation is offset by allowing only one-third of the credit for assets with a life of 3 to 5 years and two-thirds of the credit for assets with a life of 5 to 7 years. The combined effect of these two provisions—the absence of a basis adjustment and the statutory limit on the credit for short-lived assets—is that the investment credit provides the greatest subsidy for assets with lives of 7 years. Longer lived assets *and* shorter lived assets receive smaller effective subsidy rates. Requiring a basis adjustment for the investment credit would reduce the discrimination against long-lived assets and, therefore, reduce the necessity for statutory restrictions for short-lived assets. It would also permit repeal of the recapture rules and permit a uniform credit for both short- and long-lived assets.

Recapture.—The determination of asset life for the purpose of computing creditable investment is generally performed when the asset is placed in service. In the event of early disposition, the credit is recomputed if the limitations on short-lived assets apply to the actual asset life. Any difference between the investment credit claimed and the investment credit that would have been claimed if the actual life were used is recaptured.

Recapture provisions are an additional source of complexity in the investment credit. Recapture would not be an issue if the investment credit were not limited for short-lived assets; but this requires a basis adjustment.

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The 1974 Treasury proposals

This discussion has illustrated some of the complexities and problems that have arisen from subsidizing the purchase of capital equipment through the tax system. I have mentioned how it is possible to design an investment tax credit exactly equivalent to a cash grant subsidy that would reduce these complexities and make the subsidy more neutral. The Treasury Department's 1974 proposal for restructuring the investment credit would have accomplished this objective. Along with increasing the rate of investment credit from its then 7-percent rate to the current 10-percent rate, the Treasury proposed to:

- Eliminate the limitations based on useful life so that all property with useful life of more than 3 years would qualify for the credit.
- Provide for full refundability of the investment credit with a 3-year phase-in.
- Require the taxpayer to reduce the cost basis of qualifying property for depreciation by the amount of the investment tax credit.

Pros and cons of restructuring

Restructuring the credit, as proposed by the Treasury in 1974, would eliminate many of the problems of the current law. It would provide for an equal reduction in the cost to private firms of all assets with a life over 3 years. By not providing any tax-exempt income, it would be equally valuable to taxpayers in all income brackets. It would eliminate the need for complex carryover and carryback provisions and for recapture. Taxpayers would not engage in leasing transactions solely for tax purposes. In conjunction with the other changes, the credit rate could be altered to provide the same overall incentive to investment.

Although this type of restructuring has advantages and may indicate how the investment credit should have been designed originally, there are problems in changing current law. First, while the credit rate could be adjusted to maintain the same overall incentive, the benefits to some firms would increase and to others would decrease. Raising the credit rate to prevent major losses to any industry from the change would require a significant increase in the average investment incentive and would result in a large revenue loss to the Treasury. In addition, even if the average incentive to investment is unchanged, the restructuring proposed in 1974 would cause a significant immediate revenue loss to the Treasury. The revenue loss from increasing the rate of the credit would be incurred immediately while the revenue gains from requiring a basis adjustment would accrue over the life of the asset. Thus, even if the present value of revenue to Treasury is unchanged—the higher future revenue offsetting the immediate lost revenue—the deficit would be increased in the short run from the restructuring proposals.

Conclusion

The investment tax credit is a major tax expenditure program designed to increase investment, particularly in machinery and equipment. Available econometric research shows that it does promote increased investment, but its cost effectiveness at achieving this objective is still in dispute.

The investment credit is not a reliable tool of countercyclical policy. Changes in the investment credit should be considered only in the context of overall policies to stimulate longrun capital formation, and not to offset a temporarily overheated or depressed economy.

The investment credit could be made more similar to a direct expenditure program by allowing refundability, requiring a basis adjustment, and permitting the same credit rate for all asset lives. These changes if adopted as a package, would reduce the bias against short-lived and very long-lived assets in the present credit, reduce tax shelter problems, end the artificial encouragement to leasing, and eliminate the necessity for complex carryover rules. On the other hand, such a restructuring of the investment credit would be difficult to accomplish without large shortrun, or even permanent revenue losses.

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Exhibit 41.—Statement of Assistant Secretary Lubick, May 14, 1979, before the House Ways and Means Committee, on H.R. 3712, a bill to prohibit the use of tax-exempt bonds for single-family housing

We welcome the opportunity to present the administration's views on H.R. 3712. The bill would generally prohibit the use of tax-exempt bonds for single-family housing.

We are pleased to give H.R. 3712 our full and unconditional support in all material respects. Over the past few months, we have become increasingly concerned that mortgage subsidy bonds are wasteful, expensive, and inflationary. By 1984, they could cost the taxpayers of this country as much as $10 or $11 billion a year. Most of this money would be wasted; very little would go to those families who actually need public assistance. At the same time, these billions of dollars would add to inflation in the price of housing and other goods and services. We believe that Mr. Ullman, Mr. Conable, and the other distinguished sponsors of H.R. 3712 have addressed these concerns in a sound and responsible manner.

Background

In the past few years, there has been an explosive increase in the volume of tax exempt revenue bonds issued by State and local governments for the purpose of making low interest mortgage loans for single-family homes. The Congress, the press, and the public have become increasingly concerned about these bonds. Their use has been condemned in publications of such diverse editorial opinion as the Washington Post, the Wall Street Journal, and the New York Times.

Because interest on these bonds is tax exempt, the bond proceeds can be used to make mortgage loans at approximately 2 percentage points below conventional mortgage rates. The security for the bonds is a pool of mortgage loans made with the bond proceeds, and the bonds are serviced by principal and interest payments collected from the individual mortgagors. The bonds are not backed by the credit of the issuer.

These mortgage subsidy bonds are part of a growing trend of using tax exempt bonds for private purposes. Traditionally, tax exempt bonds have been used almost exclusively for essential public projects such as roads, schools, and municipal buildings. They have not been used for such private purposes as single-family housing.

A few State housing agencies began to issue small amounts of tax-exempt bonds for single-family housing in the early and middle 1970's. Most other State agencies adopted the practice in 1977 and 1978. However, the full extent of the potential volume of these mortgage subsidy bonds was not revealed until July of 1978. At that time, a major municipality sold a $100 million issue for homebuyers having annual family incomes of $40,000 or less. This was the first instance in which an issuer other than a State housing finance agency sold revenue bonds to make mortgage loans for single-family housing.

Other localities soon concluded that they too could sponsor revenue bond programs at little or no cost to themselves. Experienced investment bankers have prepackaged plans that they can modify to fit the specifications of nearly any locality. Local savings and loans handle the administrative chores of processing loan applications, selecting those that are creditworthy, and collecting monthly mortgage payments. Private insurance companies (or the FHA or the VA) provide layers of security for the bondholders. Finally, the locality itself is not responsible in the event of default. The locality does not back the bonds in any way; security for bondholders is provided solely by the mortgages and mortgage insurance, and by reserve funds set up from bond proceeds at the time of issuance. Because localities have no responsibility and take no risk, they have every incentive to issue as many mortgage subsidy bonds as the market will bear.

To say mortgage subsidy bonds are spreading like wildfire is an understatement. During 1978, $622 million of these mortgage subsidy bonds were sold by localities, and the potential volume in 1979 is at least $3.8 billion. This explosive growth has occurred even though only about a dozen States currently have laws permitting localities to issue revenue bonds for this purpose. We expect that the vast majority of States will

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enact legislation authorizing issuance of these bonds in the next few years. Even now, enabling legislation has been introduced in many States.

The potential growth of mortgage subsidy bonds is enormous. In 1978 approximately $176 billion of gross new mortgage loans were made for single-family housing. The total of all mortgage subsidy bonds in 1978 amounted to less than 3 percent of this volume. By way of comparison, the total volume for 1978 of all municipal bond issues was approximately $46 billion.

In 1968, Congress attempted to restrict the use of tax-exempt bonds to traditional public projects. These include low-income rental housing, but not single-family homes. Low-income projects afford the basic necessity of shelter to poor families. Single-family homes, by contrast, not only furnish shelter but perhaps also represent the best investment that most American families can make.

It is true that the present statute contains language ("residential real property for family units") broad enough to permit tax-exempt bonds for single-family housing. However, this was apparently an oversight. The statutory language was written in 1968, at a time when housing bonds were for multifamily projects; revenue bonds for single-family housing were virtually unknown until the middle 1970's.

Cost

There surely is no way to get something for nothing. If certain homebuyers save money because of tax-exempt bonds, these savings have to come from somewhere. And indeed they do: the taxpayers pick up the tab.

The total cost of mortgage subsidy bonds depends directly on the volume of these bonds that are sold. Therefore, our estimates of revenue loss are based on a range of reasonable assumptions about the volume of bonds. If we assume that the volume of bonds will be sufficient to finance 10 percent of home mortgages, the cost will be $470 million in 1981. On the other hand, if the volume is sufficient to finance 50 percent of home mortgages, we stand to lose $1.6 billion in 1981 and $11 billion in 1984. In the longer run, we stand to lose as much as $22.1 billion a year (expressed in 1984 dollars).

A study recently prepared for Congressman Reuss and the Banking Committee by the Congressional Budget Office estimated that mortgage subsidy bonds would finance about 8 percent of all mortgages in 1984. In the short time that has elapsed since the CBO study was released, it has become clear that this estimate was far too conservative.

There quite literally are no natural limits on the potential growth of mortgage subsidy bonds. Put simply, no one wants 10 percent mortgage money when 8 percent money is available. Thus, it is not unreasonable to expect that close to 40 or 50 percent of all home mortgages could eventually be financed with tax-exempt bonds.

Inflation

Mortgage subsidy bonds are highly inflationary for three reasons. First, their cost adds considerably to the budget deficit. The American people will perceive that we do not take inflation seriously if we choose, in effect, to spend billions of dollars annually on a new program of housing subsidies for the middle class.

Second, mortgage subsidy bonds have a direct and immediate impact on housing prices. By adding demand to a housing market that has been overheated, these bonds could have a substantial impact on the price of a home.

Third, mortgage subsidy bonds tend to frustrate monetary policies designed to help bring inflation under control by gradually cooling off the economy. Historically, the housing market has been especially sensitive to high interest rates. Consequently, when interest rates rose during previous business cycles, demand for housing fell off and this helped to stabilize the economy. During the most recent business cycle, however, the housing market has been largely insulated from the effect of higher interest rates. At first, money market certificates issued by savings and loan associations attracted a significant amount of additional capital to the housing market. More recently, we have attempted to correct the situation by reducing interest rates on these money market certificates. However, mortgage subsidy bonds threaten to defeat our efforts to have the housing market contribute its share to cooling off the economy. They insulate housing from high interest rates even more effectively than

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money market certificates; not only do the bonds attract capital, but they do so at below market rates.

Waste

Mortgage subsidy bonds are both wasteful and inefficient. The case for mortgage subsidy bonds is based on two premises: First, that middle class Americans need public assistance to buy homes, and second, that tax-exempt bonds are the best way to provide that assistance. We believe that both of these premises are incorrect.

The first premise seems to assume that the majority of Americans need public assistance. This assumption turns the world upside down. It seems elementary that public assistance must be limited to those who could not otherwise afford basic necessities. Public assistance for housing must be limited to those families who need help if they are to have a safe and decent place to live.

Fortunately, middle class Americans do not need public assistance to buy homes. Even at the lower end of the middle class, most Americans are able to afford their own homes. For example, our most recent statistics show that nearly two-thirds of all families with incomes of between $10,000 and $15,000 own their own homes.

If mortgage subsidy bonds ever make any sense at all—and we don't believe that they do—it can only be when they are used for families who have no other way to get a mortgage. However, most of these families are necessarily excluded from mortgage subsidy bond programs. In order to attract investors and to obtain necessary insurance, mortgage subsidy bonds can be used only for families who meet conventional credit standards. In other words, if a family qualifies for a mortgage loan at a local bank or savings and loan association, then they can qualify for assistance under a mortgage subsidy bond program. However, if the family is not able to qualify for a conventional mortgage loan, then they are almost certain to be shut out of the subsidy program. Thus, families who do not have access to conventional sources of credit are unlikely to benefit from these bonds.

Moreover, mortgage subsidy bonds cannot possibly benefit families in the lowest income groups because these families simply are not able to afford their own homes. Consequently, mortgage subsidy bonds do nothing for those most in need of housing assistance.

The second premise is also incorrect. All tax-exempt bonds are inefficient in the sense that the average cost to the taxpayers exceeds the savings to the issuer of the bonds. This inefficiency is compounded in the case of mortgage subsidy bonds because a significant portion of the bond proceeds are not used to make mortgage loans, but instead are wasted on lawyers' fees, underwriters' fees, reserve funds, and other similar items. In addition, substantial administrative fees must be paid each year. The net result can be that of each $1.00 of cost to the taxpayers, significantly less than 50¢ or 60¢ is actually passed on to homebuyers.

Additional policy considerations

Over a period of years, mortgage subsidy bonds could result in substantial changes in the basic structure of our economy and tax system. We would like to address a few of the most important of these changes.

First, there would be a sizable shift in the allocation of capital between housing and other sectors of the economy. In particular, large amounts of capital would flow into the housing sector at the expense of industrial plant and equipment. This could only serve to aggravate the problems we have had over the past 5 or 10 years in promoting capital formation.

In this regard, it should be noted that existing Federal policies do much to attract capital into the housing market. For example, tax expenditures for single-family housing (i.e., deductions for mortgage interest and property taxes and special capital gains rules) will alone amount to more than $16 billion in fiscal year 1980. This is in addition to extensive programs for mortgage insurance. It is doubtful that we should do very much more to encourage capital investment in housing at the expense of industrial plant and equipment.

Mortgage subsidy bonds also have a direct effect on the stock market. To a fair extent, stocks and tax-exempt bonds compete with each other for the same funds.

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Many wealthy investors who can afford to take risks in the stock market are attracted instead to tax-exempt bonds. Mortgage subsidy bonds could easily result in a doubling of the supply of tax-exempt bonds that comes to market. If they do, this could frustrate many new and growing corporations in their attempts to raise venture capital.

Second, there could be a substantial effect on the market for tax-exempt bonds. In the first quarter of this year, mortgage subsidy bonds accounted for nearly 30 percent of all new issues. This additional supply had a considerable impact in driving up interest rates on tax-exempt bonds, but H.R. 3712 has already brought these rates down. Compared to interest rates generally, tax exempt rates have become very low by historic standards as a result of the introduction of H.R. 3712.

More precisely, it has been estimated that tax exempt rates increase by between 4 and 7 basis points for each billion dollars of mortgage subsidy bonds sold. As tax exempt rates increase, it becomes progressively more expensive for State and local governments to finance essential public projects such as schools, roads, and other public works. Some localities, especially those with a weaker credit, may be denied access to the market altogether. It has been estimated that each billion dollars of mortgage subsidy bonds drives perhaps $100 million of conventional municipal bonds off the market.

The impact on other tax exempt housing bonds will be especially severe. It has been estimated that each billion dollars of mortgage subsidy bonds will result in an increase of between 11 and 14 basis points in the cost of tax exempt financing for low- and moderate-income rental projects. Thus, mortgage subsidy bonds will actually increase the cost of shelter for those most in need.

In addition, if mortgage subsidy bonds are part of a trend—and they would appear to be—radical changes could be ahead for the tax exempt market. This market has been increasingly diverted from its historic use for traditional public projects. For example, revenue bonds now comprise about two-thirds of the tax exempt market, while general obligation bonds were predominant as recently as 2 or 3 years ago. As the tax exempt market expands, there will be a considerable change in the method of allocating capital within our economy. Decisions about the allocation of capital will be made increasingly by government, and not by market forces.

This administration has consistently recognized the need for a strong and active tax exempt market so that State and local governments can effectively carry their share of responsibilities under our Federal system. However, as the tax exempt market swallows up an increasingly large share of the sources of capital, its purpose is diluted and its effectiveness is diminished.

Third, mortgage subsidy bonds raise substantial questions about the role of government in our free enterprise system. In many localities across the country, government has gone into business in direct competition with local banks and savings and loan associations. As a major newspaper has noted, this development "carried to its logical, which is to say political conclusion, ... would put local governments in full competition with private enterprise—the banks and savings and loans. Those institutions could not win in such a competition because of the income-tax quirk and might well be replaced eventually by local governments as the source of almost all mortgage money." (*The Washington Post,* April 21, 1979, p. 14.) We do not believe that it would be healthy to have government replace free enterprise in such a large sector of our economy.

Fourth, a large increase in the volume of tax-exempt bonds would do considerable injury to the fairness of our tax system. It would literally make it possible for wealthy investors to escape taxes completely on billions of dollars of income each year. We should not be making it any easier for the rich to avoid paying taxes.

Other provisions

H.R. 3712 would continue to allow tax-exempt financing for rental housing, but would limit such financing to low- and moderate-income projects. In some instances, tax-exempt financing has been used in connection with high-rent projects for the well-to-do. Therefore, we believe a limit of this kind is necessary and appropriate. However, we are concerned that the bill may go too far in limiting efforts to promote economically integrated rental housing for low- and moderate-income families.

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The bill also would allow States to finance homes for veterans with tax-exempt general obligation bonds. We believe that the committee should eliminate this provision.

For the next several days, the committee will be hearing testimony from a number of witnesses who have sincere concerns about various provisions of H.R. 3712. We understand that members of the committee may want to accommodate certain of these concerns. For example, as noted above, some economically integrated rental projects may inadvertently have been affected. In addition, there is some concern regarding transitional rules for financings that were vary far along on April 24. We would be glad to work with the committee and its staff in developing such changes as may be necessary.

Conclusion

In concluding, we would like to return to the three points that we made at the beginning of our testimony. First, mortgage subsidy bonds are enormously expensive and could eventually cost as much as $10 or $20 billion a year. Second, they make it harder to solve this nation's number one economic problem, which is inflation. And third, they waste an enormous amount of money on public assistance for the well-to-do. For these reasons, we are opposed to mortgage subsidy bonds, and are in full agreement with Mr. Ullman, Mr. Conable, and the carefully thought out legislation that they have introduced.

APPENDIX A.—*Calender year change in tax liability under H.R. 3712*

Projected market share in 1984 of single-family mortgages financed with tax-exempt bonds	1979	1980	1981	1982	1983	1984
			$ millions			
0.10	39	183	469	920	1,549	2,345
0.20	50	260	771	1,643	2,878	4,492
0.30	56	325	1,057	2,368	4,236	6,681
0.40	63	382	1,331	3,082	5,586	8,868
0.50	68	434	1,598	3,791	6,931	11,049

APPENDIX B.—*Longrun reduction in tax liability from tax exemption of mortgage subsidy bonds (excluding veterans' programs)*
[$ millions; 1984 levels]

Market share of single-family mortgages financed with tax-exempt bonds under current law	Revenue cost—current law
0.10	4,413
0.20	8,826
0.30	13,239
0.40	17,652
0.50	22,064

NOTE.—These figures reflect volumes of mortgages outstanding financed with tax-exempt housing bonds at alternative projected longrun shares of mortgage market. The projected end of 1984 stock of all outstanding mortgages for single-family housing is $1,678.3 billion.

Exhibit 42.—Statement of Deputy Assistant Secretary Halperin, May 23, 1979, before the Subcommittee on Legislative Process of the House Rules Committee, on the effect of the "sunset" concept on tax expenditures

It is an honor to appear before you to present the views of the Treasury Department on sunset legislation. The administration witnesses thus far have emphasized the importance of the sunset concept as applied to Government programs generally. As you are aware, Government programs include tax expenditures as well as direct

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expenditures. If we are to gain better control over Federal programs, it is essential that we examine both types of expenditures.

I will begin by discussing the general problem of tax expenditures. Then I will turn to the different ways in which the sunset concept can be applied to tax expenditures. Next, I will discuss some technical aspects of tax expenditure sunset. I will then consider some general policy matters and the criticisms most often leveled at applying sunset to tax expenditures. Finally, I will discuss H.R. 2 and H.R. 65, the bills now before you, and indicate the administration's views in light of the goals of sunset.

It is important to note that sunset does not *eliminate* any tax expenditures. All sunset does is subject tax expenditures to a system of controls no more burdensome or restrictive than that which applies to direct expenditures.

The tax expenditure problem

Our Government frequently turns to the tax system as a means of resolving the social, political, and economic problems of the day. For the most part, these programs take the form of tax expenditures.

The tax expenditure concept is not complicated. The Federal Government has two basic means by which it can carry out its programs. It can do so directly such as by making grants and loans, or it can specially reduce liabilities otherwise owed to the Government. The two methods are economically equivalent. A potential recipient can be provided the same amount of aid using either method. When the liabilities owed to the Government are tax liabilities, we refer to the special reductions as tax expenditures since they are economically and functionally equivalent to direct expenditures.

Consider a very simple example. A business owes $1 million in income taxes to the Federal Government. To encourage this business to undertake a project, the Government has decided to provide $400,000 of direct economic assistance. The Government may transfer this aid using one of the two basic methods. The business can be required to pay $1 million in income taxes and a grant of $400,000 can be made directly to the business. Or $400,000 of tax liability can be cancelled, leaving a net tax payment of $600,000. The grant would appear as a direct outlay of the Government. The reduction in taxes would be treated as a tax expenditure. In either case, the business has received the same amount of economic assistance. (To obtain equivalence, the $400,000 of tax reduction must itself be considered taxable income as a direct grant would be.) In the case of the tax expenditure, the Federal income tax system is being used simply as a means of transferring the subsidy. In other words, the subsidy is being "cleared"—that is, accounted and paid for—through the income tax system.

The Federal tax system is, to say the least, complicated. It is, therefore, essential to distinguish between the use of the tax system to transfer subsidies—which I have just described—from its basic function of raising revenues. The revenue-raising function is carried out by applying a rate structure to a tax base consisting of net income. Along with certain accounting and administrative rules, these provisions comprise the structure of the income tax system. Tax expenditures are formulated as special and distinct modifications of the basic revenue-raising structure, and are separable from that structure. Superimposing tax expenditure provisions on top of tax structure provisions complicates an already complex statute. But the resulting complexity should not be allowed to cloud the important distinction between the two functions. Tax expenditures are functionally the same as direct expenditures, and should be similarly treated. The revenue-raising function is a separate one, and should not be confused with the expenditure function.

Tax expenditures are used to subsidize the provision of goods and services (e.g., the charitable deduction and percentage depletion), or to subsidize the use of certain production methods (e.g., energy tax credits and the targeted jobs credit). Tax expenditures are also used to provide transfers to other governmental units (e.g., tax-exempt bonds) or to individuals (e.g., exemptions for the aged or blind).

There are now over 90 different tax expenditure programs. For fiscal year 1980, the aggregate revenue loss attributable to tax expenditures will exceed $150 billion. This is more than 28 percent of the direct budget outlays for the same year. Despite their obvious budgetary significance, tax expenditures receive minimal Government control

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and coordination. Since a tax expenditure program takes the form of a modification of the tax laws, it avoids the budgetary checks imposed on direct expenditures, which must pass through both authorization and appropriation committees, and must compete with other programs within an agency budget ceiling. Tax expenditures are hidden within the tax law and are not counted as spending within the budget ceilings of any agency. In fact, tax expenditures have no aggregate dollar limitations. Tax expenditures are available simply by claiming an item on a tax return. They, therefore, operate as open-ended entitlement programs. Their cost is determined by the willingness of taxpayers to engage in certain economic activities. Unlike most direct expenditure programs, cost is not limited by annual appropriations. The tax committees, in effect, exercise both authorization and appropriation powers over tax expenditures, and usually do so on a permanent basis. A tax expenditure program thus avoids coming under the scrutiny of the committees most familiar with the subject matter of the program. Thus, the basic tools used to control other Federal programs are, for the most part, absent from tax expenditure programs. Tax expenditures, therefore, are often easier to enact and retain than direct expenditures which accomplish the same goals.

How does sunset address these problems?

"Sunset" refers to a procedural system to compel periodic review of governmental programs. In order to make review meaningful, most programs are scheduled to terminate ("sunset") on a regular basis, thereby requiring the positive action of reauthorization to maintain the program. Sunset attempts to produce greater budgetary control by requiring periodic rejustification of Government programs in order to renew spending authority.

Applying sunset to tax expenditures serves basically the same objectives as sunset generally: to provide for the evaluation of the tax expenditure in relation to the goals leading to its enactment and in light of functionally similar nontax Federal programs. This facilitates program improvement and coordination with direct expenditure programs.

Sunset makes it possible to introduce a modicum of control into the chaotic tax expenditure process. The effectiveness of the control depends on the strength and breadth of the legislation, and on the willingness of the administration and Congress to make the concept work.

There are several basic approaches to incorporating tax expenditures in some form of sunset mechanism.

A. *Review only.*—Here, the emphasis is limited to periodic review and evaluation of tax expenditures. A schedule and criteria for reviewing tax expenditures would be established. Functionally related tax expenditures and direct spending programs would be reviewed at the same time.

The purpose of review is to provide solid information on which tax expenditure programs may be evaluated. There is a surprising dearth of information comparing tax expenditure objectives with actual results, and evaluating related tax and direct spending programs. Such review is now conducted mostly on an ad hoc basis in response to the political necessities of the moment. Providing such information on a regular basis will be of great assistance in formulating legislation. To the extent that review combines the efforts of the relevant substantive committees with those of the tax committees, especially in comparing the effectiveness of tax expenditures to direct spending programs, review serves a particularly useful function. However, an evaluation report, regardless of its quality and the information provided, cannot by itself guarantee congressional consideration. The issue is whether an automatic mechanism for terminating tax expenditures is necessary to cause Congress to focus its attention on a tax expenditure.

B. *Two-step termination proposals.*—This approach, found in title VII of H.R. 2, requires two separate pieces of legislation. The first bill establishes the termination and review structure, which is then activated to the extent provided in the second bill. The second bill is treated procedurally in much the same manner as a normal tax bill and allows the traditional tax legislative process to set termination dates and define the

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scope of tax expenditure sunset by use of outright exemptions or through transition, grandfathering and substitution rules.

The two-step approach has the advantage of allowing for congressional action on the basic structure without introducing at the outset all of the controversy surrounding termination of tax expenditures. Also, by placing responsibility for determining the scope of tax expenditure sunset in the tax-writing committees, this approach tends to preserve current legislative jurisdiction.

The usefulness of this approach depends on the prospects for the second bill. Since the termination dates and exemptions set in the second bill prescribe the review structure, a review process is established only to the extent provided in the second bill. Thus, the outlook for establishing a strong review structure is tied to the willingness to provide for termination.

C. *Automatic termination.*—The broadest possible approach to tax expenditure sunset is to prescribe termination dates for all tax expenditures in conjunction with a review process. This approach takes the most direct route to the objectives sought by applying sunset to tax expenditures. To the extent termination dates are provided, the review mechanism becomes more effective, and tax expenditures are placed more on a par with direct expenditures. *There is no apparent reason why most tax expenditures should not automatically terminate unless reenacted by Congress.*

D. *Apply mandatory termination dates to new tax expenditures only.*—A variation on the previous approach is to require only that all new tax expenditures contain termination dates. This is the approach taken by title IV of H.R. 65. Given the rate at which tax expenditures are now being enacted, such a requirement could be useful. The enforcement mechanism for this approach suggested in previous proposals is to make out of order the consideration of any bill, amendment, resolution, etc., which includes a tax expenditure and which does not contain termination provisions meeting certain requirements.

Problems of applying sunset to tax expenditures

A. *Definition of a tax expenditure.*—The existence and definition of tax expenditures have been the subject of some debate. Yet, those responsible for applying the concept—Treasury, OMB, the Congressional Budget Office, and the Joint Tax Committee—have been in almost complete agreement in identifying the tax expenditure items of the budget. Given this historical consistency, the actual application of sunset to tax expenditures is likely to produce few, if any, definitional problems.

B. *Technical interdependencies.*—Elimination of one section of the tax code may affect related sections. But interdependency problems may also be created when direct expenditure programs terminate. Further, in most cases, this will be a purely technical problem, requiring careful draftsmanship and a knowledge of any concurrent changes in the tax law. In some cases, however, the interrelationships are important, and may call for broad review. The capital gains provisions are a good example of this second category. Technical interdependencies attest to the complexity of the tax code, and not to any inability to evaluate tax expenditures.

C. *Transition rules.*—Transition rules are required when tax laws change in order to mitigate detrimental reliance on existing law. Similar examples of reliance would also be found when subsidies and other direct expenditure programs are abruptly terminated. In either case, transition rules should generally be formulated as part of the review of a given expenditure program, and not in conjunction with creating a system of review.

D. *Substitution rules.*—If a substitute program is not in place, automatic termination of a tax expenditure often means either the elimination of any means to accomplish a program objective or the creation of a structural "gap" in the tax law. As a result, a proposal to repeal a tax expenditure will often be accompanied by a substitute provision to accomplish the same objective or fill the "gap" (if any). For example, the President's 1978 tax program recommended a taxable bond option to encourage States and localities to substitute subsidized taxable borrowing for tax-exempt borrowing.

Similar substitution problems may be created by termination of direct expenditure programs. For example, if current welfare programs automatically expire, some

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substitute would be needed to accomplish the same goals. In some cases, however, such as foreign income deferral where the tax expenditure may be terminated only by substituting a structural alternative, applying sunset to tax expenditures may be different from applying sunset to direct expenditures. This distinction is an extremely narrow one, and does not warrant treating all tax expenditures differently from direct expenditures.

Administrative position

In view of the general policy considerations set out above, we believe that the following decisions should guide your consideration of applying sunset to tax expenditures.

Tax expenditures are now subject to significantly less budgetary control than direct expenditures. Accordingly, we strongly urge that whatever sunset legislation is ultimately approved by the Committee not further increases the budgetary control gap between tax and direct expenditures.

At the very least, sunset legislation should provide extensive mandatory review of all tax expenditures. Tax expenditure review should be coordinated to the maximum extent possible with direct spending review. Tax expenditure review should incorporate the views of the authorization committee, and should be predicated on comparing the effectiveness of tax expenditures with related direct expenditures. We see no reason to exclude any tax expenditure from review, regardless of whether any tax expenditures are excluded from termination.

Sunset legislation should provide dates by which congressional action will be required in order to maintain tax expenditures. This simply corrects for some of the imbalance between tax and direct expenditures and helps ensure that tax expenditure review would be meaningful. Termination dates should be coordinated with functionally related direct expenditures.

It may be desirable, in the Committee's judgment, to exclude a few tax expenditures from the termination schedule. If the Committee is so inclined, we will be happy to work with you in examining the tax expenditure budget, and evaluating the various provisions in the light of the criteria the Committee has developed for exclusion of both direct and tax expenditures.

It is unnecessary, and may well be undesirable, for sunset legislation to include rules which may be needed in the event that specific tax expenditures are allowed to terminate. We recognize that in that event, rules might be needed to provide grandfather protection for those who relied on existing law and to substitute a direct expenditure provision or to conform the tax law to the lapse of certain provisions. However, such rules have not been included in the direct expenditure part of sunset legislation. On this basis, therefore, there is no logical reason to require such rules for tax expenditures. The sunset bill should direct that these rules be developed in conjunction with review of a tax expenditure provision as part of the evaluation of the question of termination. The choice of substitution provision (if any) should follow from the results of review, and not from a current notion of appropriateness. Finally, it does not appear worthwhile to engage now in a protracted debate on substitution and similar rules since no decision has been made yet to terminate anything.

Traditional arguments against applying sunset to tax expenditures

A. *Applying sunset to tax expenditures creates serious problems for business certainty.*—It is often argued that applying sunset to tax expenditures unduly disadvantages the business community because of increased uncertainty in planning investments. Businesses will be less willing to invest if tax expenditures will be regularly reviewed and possibly terminated.

Many of those who assert this view nevertheless endorse applying sunset to *direct* expenditures. These two positions cannot be reconciled. Firms making investment decisions involving tax expenditures are in no different a position from firms who must consider whether Federal spending and subsidy programs will be continued. Investment decisions are dependent on Federal spending programs, such as highway construction, housing, military procurement, research and development, agriculture,

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and a variety of economic development programs. All of these doubtless influence business investment decisions.

Since investment is dependent on all Federal programs—direct as well as tax—the issue really is whether such reliance should *preclude* regular, meaningful review of all Federal programs affecting the business community. We would submit that securing the most efficient use of Federal resources is of paramount concern. The resulting uncertainty, if any, can be managed by the business community, as are other investment risks. We cannot accept the proposition that all Federal subsidies to business must be provided permanently.

B. *Sunset is a massive tax increase in disguise.*—Another argument often heard is that applying sunset to tax expenditures constitutes some sort of "backdoor" tax increase.

This argument plays upon the confusion inherent in the two roles the income tax performs—raising revenue and providing subsidies. The income tax provisions affected by sunset are subsidies which happen to be cleared through the tax system. Accordingly, setting a termination date for a tax expenditure means nothing more than the fact that a subsidy has been scheduled to terminate. When compared with direct expenditure programs, this is surely not a novel concept. It may be that termination of some tax subsidies economically calls for a general tax cut, but only on the same grounds that would apply where terminating a direct expenditure might also justify a tax decrease.

C. *Applying sunset to tax expenditures presumes that a taxpayer is only entitled to what the Government doesn't tax away.*—The existence of Government and allocation of certain functions to it means that a specified portion of national income will have to be paid in taxes. We have, in fact, decided to finance a large part of the cost of government by means of an income tax. No one suggests that this in itself presumes all income belongs to the government. Government spending may be provided either directly or by specially foregoing revenues otherwise due. Direct government action and special income tax modification are simply policy alternatives. Programs may be implemented either way. There is nothing in the tax expenditure concept any more than in the existence of an income tax that implies that the Government has a "right" to income or to anything else. The tax expenditure concept simply serves to identify certain government policies more accurately, namely, as subsidies or transfers.

H.R. 2 and H.R. 65

Let me now turn to the two bills which are before the Committee.

The nontax part of H.R. 2 would establish a 10-year schedule for the mandatory reauthorization of selected Federal programs, beginning on September 30, 1982. If a program is not reauthorized in accordance with the bill, there would be no further provision of appropriations, obligations, or expenditures for the program. Subsequent reauthorization of programs would take place at 10-year intervals after the initial review date. Other provisions set up review procedures, and other procedural elements for sunset.

Title VII of H.R. 2 applies to tax expenditures. I have discussed title VII in connection with the approaches to applying sunset to tax expenditures. Title VII is the two-step approach. In the first step, a bill is passed which provides a basic structure for incorporating tax expenditures in sunset. In the second step, the bill goes through the normal tax legislative process, and allows for great discretion to the tax committees to decide what is included in sunset termination, and how. The second step is also to include transition, substitution, and other technical rules for any tax expenditures scheduled for termination.

We believe that title VII represents a constructive step in the right direction. However, as indicated in our testimony, we would prefer a tax expenditure title that directly sets termination dates for tax expenditures. Moreover, we would not want to see technical rules such as substitution and grandfathering provisions included in initial sunset legislation. These rules should be the product of sunset review.

H.R. 65, introduced by Mr. Derrick, is another constructive step in the right direction. The bill would require that legislation to provide new or increased tax expenditures satisfy certain procedural requirements such as stating the objectives of

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the program and providing an annual report to Congress evaluating the program in terms of its objectives. In addition, H.R. 65 would preclude consideration of a bill or a resolution providing new or increased tax expenditures for a time period exceeding 5 years. Thus, in effect, 5-year termination would be applied to all tax expenditures covered by this provision.

Clearly, the objectives of H.R. 65, as with title VII of H.R. 2, are consistent with our views of applying sunset to tax expenditures. We would, however, much prefer to have both review and termination apply to existing, as well as new, tax expenditures. In addition, the effect of H.R. 65 is to set a separate review cycle for new tax expenditures. This cycle may, or may not, coincide with the general functional review cycle to which the new items relate. We think it would be preferable for review and termination of new tax expenditures to be coordinated as closely as possible with existing tax expenditures and other federal programs.

Conclusion

As we have seen, subsidy programs may be formulated either as direct expenditures or as tax expenditures. The choice depends on many considerations, not the least of which are that tax expenditures are easier to enact and are not subject to review or termination.

If an effective sunset mechanism is applied to direct expenditures and not to tax expenditures, the disparity between direct and tax expenditure control will widen significantly. This will only serve to increase the pressure to enact more tax expenditures.

We cannot stress this point too much. If the Committee approves an effective sunset mechanism for direct expenditures, and does not provide a similar mechanism for tax expenditures, it will simply be shifting more of the budget control problem from direct to tax expenditures. If anything, tax expenditures now require greater budgetary control improvements than direct expenditures. We, therefore, hope that the Committee will include an effective sunset mechanism for tax expenditures in any bill that it approves.

Exhibit 43.—Statement of Assistant Secretary Lubick, June 20, 1979, before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee, on the administration's proposal for flat-rate withholding on compensation paid to independent contractors

We welcome the opportunity to present the administration's proposal for resolving the employee-independent contractor problem. This problem and its solution are of major importance to the integrity of our income and social security tax systems.

Introduction

Some workers bear more than their share of the income tax and social security tax burden. This is so because all workers are not treated alike for purposes of Federal payroll taxes and income tax withholding. The vast majority of the Nation's workers are employees who pay taxes on their compensation through regular withholding of a portion of their pay. Still, there is another large group of our workers who are outside the withholding system simply because they are classified as independent contractors under common law standards developed hundreds of years ago.

Substantial numbers of these so-called independent contractors do not pay their fair share of tax each year because they fail to report the full amount of their income. This noncompliance diminishes public respect for the operation of the tax system and jeopardizes our system of voluntary compliance. Moreover, such conduct is patently unfair to honest taxpayers who must, as a result, bear a larger share of the tax burden.

In a recent study conducted by the Internal Revenue Service of compliance in reporting payments for services, at least 47 percent of workers treated as independent contractors did not report any of the compensation in question for income tax

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purposes. An even greater percentage, 62 percent, paid none of the social security tax due on their compensation.

Moreover, independent contractors bear less than their fair share of the social security tax burden even when they report all of their income. Although employees and independent contractors receive identical social security benefits, the social security taxes imposed on independent contractors under the Self-Employment Contributions Act (SECA) are lower than the social security taxes an employee must bear under the Federal Insurance Contributions Act (FICA). (Although one-half of the FICA tax is technically paid by the employer and one-half by the employee, in an economic sense the entire burden of this tax is borne by the employee.)

On the one hand, the opportunity for lower social security taxes and no withholding (accompanied by widespread noncompliance) constitutes a strong financial incentive for payors and workers to avoid "employer-employee" status. On the other hand, a primary goal of our tax system is to insure that everyone pays a fair share of the income and social security tax burden. These are the roots of the employee-independent contractor problem.

Summary of the administration's proposal

Prevention of large-scale noncompliance by independent contractors is a common goal of the administration and the Congress. We believe that a system for withholding tax on compensation paid to independent contractors is the only effective way to achieve this goal.

We propose that a flat rate of 10 percent be withheld from payments made in the course of a trade or business for services provided by an independent contractor. Exceptions would permit individuals who work for five or more payors or who would be overwithheld to elect out of the system. The withheld taxes could be credited first to the worker's SECA tax liability and second to his or her income tax liability. To complement this simplified withholding system, we are also proposing measures to strengthen the information reporting requirements of present law.

In addition, we believe that correcting the disparity between the FICA and SECA tax rates should be considered in the future as part of the broader issue of social security financing, and we would be pleased to work with the Congress to this end.

We also recommend a provision to ameliorate the financial impact upon payors whose workers are reclassified as employees. Under our proposal, in lieu of the payor's liability under present law for income and FICA taxes which should have been withheld, payors will be liable only for a penalty tax of 10 percent of the amount of wages not withheld upon. This penalty tax would be abated if it were reasonable for the payor to conclude that a worker was an independent contractor and the payor withheld a flat rate of 10 percent from the worker's compensation (or was excused from withholding because the worker elected out of the system).

We believe that our proposal addresses the major issues involved in the employee-independent contractor problem: The noncompliance by workers not subject to withholding, the FICA/SECA rate differential, and the burden of large liabilities in employment tax cases for withheld taxes. It is not, however, a one-sided proposal. While we have attempted to protect the Federal fisc, at the same time, we have tried to be responsive to the concerns voiced by taxpayers about so-called retroactive assessments and the importance of being an independent businessperson.

Now, I should like to discuss our specific proposals in some detail. Before doing so, however, I shall briefly review the IRS compliance study. A more detailed description of this study is contained in the Appendix.[1]

The IRS study

In order to provide a complete picture of compliance in this area, beginning in the fall of 1978 the IRS undertook a comprehensive study of income and social security tax compliance by workers treated as independent contractors. The study focused specifically on industries in which disputes between taxpayers and the IRS as to the

[1]Not included in this exhibit.

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employment status of workers have frequently arisen. To begin with, a list of the workers from all open examination cases involving the employee-independent contractor issue was obtained. A sample of more than 7,000 workers, representative of specific industries and occupations, was then randomly selected from this list. Next, the returns of those workers who could be located were fully audited by IRS agents.

Before going further, it is important to note that 21 percent of the workers in the sample could not be located. These workers were excluded in compiling our statistics on compliance. Noncompliance would be even greater if these workers were taken into account. Thus, our estimates of noncompliance are conservative.

The study demonstrates that there is widespread noncompliance by independent contractors. At least 47 percent of the workers reported absolutely none of the compensation in question for income tax purposes. This tax evasion clearly cannot be tolerated. Social security tax compliance was even worse. About 62 percent paid none of the social security tax due on their compensation.

A further finding was that noncompliance rates do not have much to do with the industry classification of the worker. Rather, the most important factors which explain noncompliance are the worker's income and the size of the payment for services. The greater the worker's income and the larger the amount of the compensation, the higher the compliance rate. This should not be interpreted to mean, however, that low compliance was confined to low paid workers. For example, over one-third of the workers with adjusted gross incomes of between $15,000 and $20,000 failed to report any of the compensation in question for income tax purposes, and over 50 percent of them failed to pay the social security tax due on such compensation.

A point worth emphasizing is that this widespread noncompliance not only deprives the Treasury and the social security system of revenues, but often deprives workers of social security coverage. The highest rates of noncompliance (and thus the greatest loss of social security coverage) are found among low paid workers, who are those most likely to need the protection afforded by social security benefits.

Finally, the revenue loss from this noncompliance is substantial. A conservative estimate of the annual revenue loss is $1 billion.

This tax evasion places an unwarranted burden upon other taxpayers. Moreover, unless Congress acts, our income and social security tax systems will be in trouble—we simply cannot expect honest taxpayers to tolerate proven, large-scale avoidance of taxes by others.

Withholding on independent contractors

At present, with some statutory exceptions, compensation is subject to withholding only if an employer-employee relationship exists under common law. In general, a worker is considered a common law employee if the person for whom the services are performed has control over the worker. Although the common law test has been used for many years, and works well in the vast majority of cases, in fact it has no direct relationship to whether workers should be subject to withholding. The technical legal distinction between "employees" and "independent-contractors" was developed in England centuries ago for purposes of determining those circumstances in which a master was liable for torts committed by his servants. For this purpose, the question of whether one person controls another was, and is, of primary importance. However, the presence or absence of "control" has little to do with whether a worker should be subject to withholding (or, for that matter, to higher premiums for social security benefits).

The most important consideration in developing a withholding system is to insure that the amount withheld approximates the amount of tax actually due. We believe that the common law works as well as it does only because it usually has the effect of implementing this more relevant policy consideration. In general, common law employees do not have substantial business expenses, so that the gross payments received by them approximate their income.

Instead of recommending that the existing system for withholding on employees at graduated rates be expanded in appropriate cases to cover independent contractors, we have developed a simplified flate-rate system for withholding which we believe will promote a high degree of compliance. However, if this simplified system is not

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successful in ending the unacceptably high rate of noncompliance among independent contractors we are willing to consider other alternatives, including an expansion of the system for graduated-rate withholding on employees that has served us so well over the years.

Under our proposal, a flat rate of 10 percent would be withheld from payments made in the course of a payor's trade or business for services provided by certain independent contractors. To further simplify the system, an exception would help assure the existence of a continuing relationship between the payor and the worker. No withholding would be required on payments to an individual who normally provides similar services to five or more payors during each calendar year. A worker would be entitled to rely on this exception if he or she (1) performed similar services for five or more payors during the preceding calendar year, or (2) objective circumstances indicate that the worker can reasonably expect to perform services for five or more payors during the year in question.

Another exception would prevent overwithholding by permitting a worker who expected to owe less tax than the amount to be withheld (taking into account any taxes being withheld by other payors) to elect out of the system simply by checking a box and signing a form that would provide the payor with the worker's name, address, and social security number that it is required to obtain for information reporting purposes under present law. A payor could also have a worker who claims to be exempt from withholding under the five-payor exception so indicate on the same form. A payor who obtained this information would not be subject to any penalties for failure to withhold if it were subsequently determined that the worker should have been withheld upon as an independent contractor.

Since the information necessary to implement a system for flat-rate withholding on payments to independent contractors must be obtained by payors to comply with the information reporting requirements of present law (the worker's name, address and social security number), the additional costs associated with flat-rate withholding should not be significant. In fact, the payor's use of the withheld tax pending payment of these amounts to the Government should offset most, if not all, of these costs.

At the same time, our proposal will lessen the burden on the worker. Withholding is a simple and relatively painless way to pay taxes when compared to budgeting for large estimated tax payments.

Flat-rate withholding would also apply to salespersons whose compensation for services is based upon the difference between the price to them of merchandise sold and its resale price. Compensation, for purposes of withholding upon these workers, would be measured by the difference between the "suggested" selling price (or estimated, if there is no "suggested" price) to the customers for the products and the purchase price paid by the worker. Regulations would be issued requiring appropriate arrangements to be made by the payor for the collection of the withholding tax. Similar requirements apply under present law for withholding income and social security taxes from employees, like agent-drivers, who are compensated in this manner.

Strengthening the information reporting requirements

For a number of reasons, information reporting can never replace withholding as a means of achieving satisfactory compliance. First, although much nonreporting is deliberate tax evasion, some of it is due to inadvertence, forgetfulness, and failure by taxpayers to keep records. Any attempt to close the entire gap of unreported income by means of information reporting and audit procedures would require millions of telephone calls, letters, and visits, many involving small amounts of tax, which would almost inevitably be regarded as harassment of "little people." A drive of such proportions could generate taxpayer resentment so great as to seriously hamper the IRS's current enforcement efforts and jeopardize the very foundation of our system of voluntary compliance. Second, the cost of following up the millions of apparent discrepancies in the reporting of compensation would be demonstrably uneconomical. Such an unbalanced enforcement effort could not be reconciled with any sound concept of tax administration. Third, even extensive pursuit of taxpayers would not achieve full collection of unpaid taxes. As demonstrated by the recent IRS study, there

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would be many unfruitful investigations where taxpayers cannot be reached by telephone or traced if they have moved. Even after the taxes have been assessed, it may be impossible or uneconomic to collect them.

For these reasons, as well as others, we believe a system for withholding on independent contractors is preferable to a system of reporting, matching, and enforcement. On the one hand, since a number of workers still will not be subject to withholding it is necessary to complement the withholding system with an effective information reporting system. Consequently, we propose three measures designed to strengthen the information reporting requirements of present law:

First, we recommend that penalties for failure to file information returns be increased to 5 percent of payments not reported, with a minimum penalty of $50. The penalties under present law for failure to file information returns of $1.00 per failure to file a return, with a maximum penalty per calendar year of $1.000, are inadequate. The IRS estimates that fewer than 60 percent of the required information returns for nonemployee compensation are actually filed.

Second, to remind independent contractors of items of income not subject to withholding when preparing their tax returns, we propose that payors be required to provide copies of information returns to workers. Penalties for failure to provide these copies would be the same as for failure to file the returns.

Finally, information reporting should be extended to compensation for services performed by salespersons based upon the difference between the cost and selling price of goods sold.

Revenue estimates

Our proposals for withholding and strengthened information reporting will result in a significant increase in compliance in the reporting of income by self-employed workers. A conservative estimate of the annual revenue gain is $600 million.

Differences in social security tax burdens

Although not central to the issue of compliance, in considering this question it is important to bear in mind the effect of the differing social security tax rates for employees and the self-employed.

FICA taxes are paid at a higher rate than SECA taxes on the same amount of compensation—currently the first $22,900 of earnings. (Moreover, earnings subject to tax under FICA are gross wages, and earnings subject to tax under SECA are net income.) Under FICA, the employee is taxed at a rate of 6.13 percent, and the employer is taxed at the same rate. Thus, the combined employer-employee tax rate under FICA is 12.26 percent. In contrast, the self-employed pay SECA taxes at a rate of only 8.1 percent. In 1981, the combined FICA tax will rise to 13.30 percent, compared to a SECA rate of only 9.30 percent.

Despite these different tax rates, both employees and the self-employed are entitled to the same social security benefits. The self-employed do not receive less medicare coverage or lower retirement or disability benefits than those who worked as employees.

Although technically the burden of the FICA tax is shared by employer and employee, in an economic sense, the entire burden is borne by the employee. In calculating the costs of labor, an employer includes not only payments made directly to employees or which are credited to their account, but also any payroll tax payments that the employer must make as a result of hiring the employee. Economists are almost universally agreed that the wage the employee receives is lower than it would be in the absence of the payroll tax. In effect, the employee pays the employer share of the payroll tax in the form of lower gross wages. The fact that employees may exclude from their income the amount of social security taxes paid on their behalf by employers in effect narrows the difference between the FICA and SECA tax rates, but only partially.

The very fact of a lower tax rate on the self-employed may cause distortions in work decisions. This is true regardless of whether there are compliance problems, although the lack of compliance by independent contractors certainly exacerbates the situation. Even when an employer-employee relationship is more appropriate and the better

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alternative on all other grounds, the fact of the higher FICA tax rates can make independent contractor status more attractive for both parties.

It would be possible to reduce the tax advantages inherent in independent contractor status by a combination of more nearly equal social security tax rates and tax deductions for income tax purposes. Such changes could make the decision as to whether to become an independent contractor or an employee more neutral and relieve much of the pressure on the question of employment status. These changes would also have the effect of increasing revenues to the social security and medicare trust funds.

We believe correcting the disparity between the FICA and SECA tax rates should be given consideration in the future as part of the broader issue of social security financing, and we would be pleased to work with the Congress to this end.

Substitution of a 10-percent penalty tax for employer's withholding tax liability

Under present law, when workers who were treated as independent contractors are reclassified as employees, in addition to their own liability for FICA and FUTA taxes, payors are liable for all income and FICA taxes which should have been withheld from workers. This withholding tax liability has been a major aggravation in employment tax disputes. Although the liability for income taxes not withheld may be abated if the payor furnishes evidence that the workers paid the proper amount of tax, often such evidence cannot be obtained, or when it can the burden of doing so is time consuming and costly. Furthermore, the liability for FICA taxes not withheld cannot be abated unless the worker paid SECA taxes and is prevented by the statute of limitations from claiming a refund of the erroneously paid SECA taxes.

To eliminate the problems associated with the payor's withholding tax liability, we propose substituting for this liability a penalty tax equal to 10 percent of the amount of wages not withheld upon. Payors whose workers are reclassified as employees would remain liable for the employer's half of FICA taxes and FUTA taxes. The worker would be liable for the employee's half of FICA taxes.

Furthermore, if it were not unreasonable for the payor to treat the worker as an independent contractor and the payor also withheld a flat rate of 10 percent from the worker's compensation (or was excused from withholding because the worker elected out of the system), the 10-percent penalty tax would be abated and the payor would only be liable for its own share of FICA taxes and for FUTA taxes.

The 10-percent penalty tax would both reduce the employer's potential withholding liability and eliminate entirely the costly and burdensome need for employers and the IRS to determine whether the worker paid income or SECA taxes, in order to abate any of the payor's withholding tax liability.

Additional considerations

We recognize that under the proposed system for flat-rate withholding it still will be necessary for a business to rely on common law standards to decide whether to withhold at a flat rate (on independent contractors) or at a graduated rate (on employees) and pay the employer's share of FICA and FUTA, and that the lack of clarity inherent in these standards has been responsible in part for some of the problems in this area in the past. However, extending flat-rate withholding to independent contractors will lower the stakes that turn on this definition for both taxpayers and the government, and therefore the number of disputes involving employment status should be reduced. Substituting a penalty for the large assessments against payors whose workers are reclassified as employees should further relieve the pressure on the common law definition of employment status. Moreover, if the inequality in FICA and SECA taxes were also eliminated, the remaining pressure on the common law test would be removed and disputes as to employment status for income and social security tax purposes should largely disappear.

Nevertheless, if absolute certainty is considered paramount, objective standards to supplement the common law and assist payors in making determinations of withholding status could be provided as part of a flat-rate withholding system. However, we strongly urge that any such criteria provide certainty by erring only on the side of classifying workers as subject to graduated-rate withholding; in no event should any

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new test allow workers who unquestionably are common law employees to escape graduated withholding and be treated as independent contractors. We must not in an effort to provide certainty also increase the number of workers who are outside of the graduated-rate withholding system that has worked so well over the years. Of course, absent flat-rate withholding on independent contractors, a test that placed more workers outside of any withholding system would be highly objectionable in light of the high rates of noncompliance for independent contractors. In addition, any test that would permit workers who are widely recognized as employees under present law to be reclassified as independent contractors could result in depriving them of many of the protections upon which they depend such as State unemployment compensation coverage.

Alternative solutions

Instead of a simplified flat-rate system for withholding on independent contractors, another effective way to combat noncompliance would be to replace the common law test and require graduated-rate withholding on all workers paid other than on a wage or salary basis, unless the gross payments received by a worker would not approximate his or her net income and it is likely the worker would provide services to multiple payors.

For example, graduated-rate withholding could be required on compensation paid to these workers unless a worker had (1) a separate place of business (other than a home office), (2) a substantial investment in assets (other than transportation vehicles used in a nontransportation business), (3) employees of his or her own who provided a substantial portion of the services for which compensation is received, or (4) substantial, continuing expenses and concurrently performed services for more than one payor.

Such a system would effectively combat noncompliance by extending withholding to cases in which withholding of income taxes is appropriate. In addition, because of the economic dependence that would exist between payors and workers covered by withholding under these criteria, inclusion of these workers within the group of workers subject to FICA would be appropriate. Indeed, if flat-rate withholding is not adopted, the noncompliance problem can only be solved by this or a similar alternative.

Finally, I would like to comment on H.R. 3245. In light of the demonstrably high rate of noncompliance among workers not subject to withholding, we oppose H.R. 3245 because it moves our tax system in precisely the wrong direction by placing an increasing number of workers outside our existing system of withholding.

In essence, H.R. 3245 would provide a safe harbor test for independent contractor status. Under the bill, a worker could be treated as an independent contractor if the following five requirements were met: (1) The worker controls the aggregate number of hours worked and substantially all the scheduling of the hours worked; (2) the worker does not maintain a principal place of business or maintains a principal place of business which is either not provided by the payor or is rented from the payor; (3) the worker has a substantial investment in assets used in connection with the performance of services or risks income fluctuation in that his or her remuneration is directly related to sales or other output rather than the number of hours worked; (4) the worker (a) performs services pursuant to a written contract which was entered before the performance of services and which provides that the worker will not be treated as an employee for FICA, FUTA, and income tax withholding purposes, and (b) is provided written notice in such contract or at the time of the contract of his or her responsibility with respect to the payment of self-employment and Federal income taxes; and (5) the payor files information returns required in respect of such service under Code section 6041(a).

First, it is noteworthy that H.R. 3245 would permit workers in all of the industries in which there have been disputes as to employment status—and in which the IRS study demonstrates high rates of noncompliance—to be treated as independent contractors.

Second, the bill would go beyond its stated purpose of clarifying the distinction between employees and independent contractors by permitting workers whose status as employees is well established to be treated as independent contractors. For example,

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long-standing employer-employee relationships could be manipulated quite easily to meet the requirements in H.R. 3245. Employees whom payors might attempt to classify as independent contractors would include any type of repairperson (for instance, someone who works for a gas, electric, or appliance company), pieceworkers and agricultural workers. Loss of status as an employee for some of these workers could also mean loss of State unemployment compensation coverage.

Third, the five-factor test in H.R. 3245 is fairly complex to apply. Innumerable new questions will be raised about what constitutes "control of hours," "rental" of a "principal place of business," a "substantial investment in assets," or "income fluctuation."

We simply cannot afford legislation like H.R. 3245 which would increase the opportunities for tax evasion by placing more workers outside our system of withholding.

Conclusion

As the members of this subcommittee consider this problem in the next few weeks, we are certain you will realize that there is no easy solution to this problem. A choice must be made between flat-rate withholding on independent contractors, expanding our system of graduated-rate withholding in cases where it would be appropriate to do so, or continuing to permit a great many taxpayers to avoid paying taxes.

Finally, we would like to stress a basic point. Withholding is the cornerstone of our tax system. Withholding benefits not only the Government, but also taxpayers by providing them with a gradual and systematic way to pay their taxes and insuring that they receive social security coverage. The thrust of our proposal is to expand this tried and true method of collecting taxes where it makes good sense and where there is good reason for doing so.

Trade and Investment

Exhibit 44.—Excerpt from Joint Communique of the Fourth Session of the United States-Saudi Arabian Joint Commission on Economic Cooperation, November 18–19, 1978, Jidda, Saudi Arabia

The United States-Saudi Arabian Joint Commission on Economic Cooperation concluded its fourth formal session today with both sides expressing satisfaction at the significant progress of joint efforts in carrying out a wide variety of economic and social development programs. Saudi Arabia and the United States agreed that the Joint Commission should expand its role in the development of key sectors of the Saudi economy at the same time that both sides were promoting increased mutual trade and private business activities.

The Joint Commission delegations evaluated the progress made on the 17 major projects being implemented under the aegis of the Joint Commission, involving the active cooperation of ten U.S. Government agencies. At the meeting, three new technical cooperation agreements were signed, in the areas of transportation, agriculture bank operations, and executive management development. Special attention was given to program objectives and how these goals might best be met.

The United States-Saudi Arabian Joint Commission on Economic Cooperation was established in accordance with the Joint Statement issued by Crown Prince Fahd and former Secretary of State Kissinger on June 8, 1974. The Joint Commission meeting, held in Jidda, November 18–19, 1978, was chaired by Minister of Finance and National Economy Muhammad Al-Ali Abalkhail. Secretary of the Treasury W. Michael Blumenthal, the U.S. Joint Commission Co-Chairman, led the United States delegation. Ambassador West, the American Ambassador to Saudi Arabia, also participated in the meeting. * * *

The American delegation held meetings outside the framework of the Joint Commission with Saudi Ministry of Finance and National Economy officials, and calls were paid by Secretary of the Treasury Blumenthal on several senior Saudi Government officials. These meetings provided fine opportunities to review the

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multiple aspects of bilateral relations, as well as to hold comprehensive discussions on the global economic and financial situation. The congressional members of the delegation appreciated the opportunity to visit Saudi Arabia and to have frank talks with key officials of the Saudi Arabian Government. It was agreed that these sessions served to strengthen the already strong feelings of friendship and cooperation between the two countries.

The two delegations noted the impressive progress which has been made since the last meeting in implementing existing technical cooperation agreements and in undertaking new project activities. Presently there are 135 American professionals working on Joint Commission projects in the Kingdom. These experts are involved in five major program areas: Agriculture and Water Resources, Science and Technology, Manpower and Education, Information and Administration, and Industrialization and Infrastructure. The financing of these projects is accomplished through a Saudi Arabian Trust Account in the U.S. Department of the Treasury.

The representatives of seven U.S. firms participating in Joint Commission programs were present at the opening and closing ceremonies of the Fourth Session.

1. Specialists in agriculture and water

Work continues to move ahead in all areas with special emphasis this next year on the following project activities: conducting detailed soil surveys in agricultural development areas; preparation of a base map depicting general soil conditions for the entire Kingdom; implementing a land allocation and record-keeping system for the Kingdom; activating native range and grazing improvement projects; installing a computerized water data base; overseeing the collection and analysis of water supply and demand data for a national water plan.

The first phase of activating the Ministry's Agriculture and Water Research Center was completed with the replacement of the American Technical Director by a Saudi national. This is one of the first steps in achieving a major Joint Commission goal of institution building.

2. Asir National Park

Progress continues on the development of the seven park sites in the Asir Province. The construction tender was advertised in September and bid openings are scheduled for late November. The construction phase will take about two years. The U.S. National Park Service will continue to assist the Ministry of Agriculture and Water in establishing this first national park in Saudi Arabia.

3. National Center for Science and Technology

During the past year the Saudi Arabian National Center for Science and Technology (SANCST) project has made significant progress in developing an institutional framework for the national development of the Kingdom's scientific potential and utilization of research results in a coordinated endeavor for social and economic betterment. Specifically, the SANCST project with NSF initiated work in major areas which will lay the groundwork for future activities at the Center. Within the next year SANCST intends to build upon these efforts by accomplishing the following:

Inventory of science and technology resources

- To complete the inventory analysis and evaluation of S&T activities in the Kingdom and to code the data for automated data processing.

Science and Technology Information Center

- To initiate work establishing and maintaining a Saudi Arabian science and technology base.
- To implement on-line searching of U.S. science and technology data bases.

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Science and technology research plan

- To complete work on a comprehensive plan for applied science and technology in the Kingdom.

The achievement of the above major objectives together with work on the institutional development of SANCST will constitute a major step in optimizing the science and technology contributions to the development of the Kingdom.

4. Solar energy research

Progress under the agreement on technical cooperation in solar energy has concentrated on projects that will have a demonstrable utility in the Saudi Arabian context in that they meet the needs of the people of Saudi Arabia even as they advance the development and application of solar technology in the United States. This will ensure that the goals are attainable within the framework of available resources; that the results of solar energy technology are readily transferable for widespread application to address the energy needs of U.S. and Saudi Arabian economies and those of developing countries throughout the world.

In the above framework, five initial programs have been selected for implementation:

- The application of photovoltaic electricity generation for a remote Saudi Arabian village.
- A study of the energy needs of the village to help determine the optimum mix of solar energy technologies.
- Development of a solar radiation map of the Kingdom through establishment and operation of a network of solar insolation measurement stations.
- Establishment of experimental test facilities for urban cooling systems at Saudi Arabian universities and a parallel effort in the United States involving innovative cooling systems in areas with similar climatic conditions to those of Saudi Arabia.
- Initiation of research and development in solar desalination technology.

5. Desalination technology

Work is progressing on the two projects under the Desalination Agreement: (1) the establishment of a desalination research, development, and training center; (2) the establishment of a technology development program which will produce designs and specifications for a new generation of large-scale flash desalting plants. The ongoing study to assess the requirements for the center will be completed this year, while the near-term objectives for the technology development project include the awarding of three concurrent contracts for conceptual designs and the development and implementation of an intermediate stage test program.

6. Vocational training and construction

Over 40 specialists from the U.S. Department of Labor are currently working with the Saudi Ministry of Labor and Social Affairs to improve vocational training programs in the Kingdom. In addition, through an inter-service agreement with the Department of Labor, five specialists from the U.S. General Services Administration are in Riyadh providing engineering oversight services for the project. The construction of 10 new Saudi vocational training centers and the expansion of 15 existing centers is planned with work on master plans and designs for these facilities now underway and actual construction expected to start early next year. The Department of Labor is also working with the Saudi education mission in Houston to monitor skill-upgrading programs being held for instructors from the Ministry's vocational training centers. Forty Saudi instructors currently are in the U.S. participating in this type of training.

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7. Consumer protection

A five-man U.S. team currently is providing technical expertise in the area of food quality control. It also has been working with the Ministry to expand capabilities in three presently operational laboratories and at the newly built laboratory in Riyadh. Graduate-level educational programs for a number of Ministry employees in chemistry, microbiology, and food science are underway in the U.S.

8. Customs

Members of a four-man team of experts from the U.S. Customs Service will begin arriving in Riyadh in January to work with the Ministry of Finance and National Economy's Customs Department in expanding its overall capabilities. A major training program for up to 95 Saudi customs inspectors a year is also scheduled to begin in the U.S. early next year.

9. Financial information services

There are now seven U.S. professionals working in the Financial Information Center. Private sector firms are carrying out the design and construction of the Ministry's new $24 million multi-media financial information center in Riyadh which is expected to be completed in April 1980. This center will provide the Ministry with expanded library facilities, will give it printing and many audio-visual production capabilities, and will give it on-line access to major bibliographic and economic data bases in the U.S. through a dedicated communication link. About 30 Saudis, under the guidance of this staff, now are planning to attend universities in the U.S.—both at undergraduate and graduate levels—in order to manage and operate the new center.

10. Statistics and data processing

The project under which the U.S. Bureau of the Census is working with the Saudi Ministry of Finance's Central Department of Statistics and National Computer Center to achieve an effective statistics and data processing capacity is now entering its fourth year. Twenty U.S. project personnel are now permanently stationed in Riyadh with two more expected within the next two months.

Major project accomplishments in conjunction with the Central Department of Statistics include completion of the 1976 census of establishments, initiation of an integrated economic survey program, significant improvement in the timely release of foreign trade statistics and the initiation of a continuing household survey program which is collecting a variety of social and economic data on the population. Project work in conjunction with the National Computer Center has included improvement in management and overall capacity to process an ever-increasing volume of work, and execution of a continuing program to provide selected Saudi officials with mid-career professional training at the Bureau of the Census in Washington, D.C.

11. Central procurement

The U.S. General Services Administration will have a four-man team of procurement and supply specialists working in the Ministry of Finance and National Economy shortly to improve its procurement capabilities. Efforts are now underway to enroll Saudis in appropriate GSA training courses in the U.S.

12. Audit management specialists

The first of four U.S. experts assigned to work with the Saudi General Control Board will arrive in Riyadh early in December. In addition to the assistance to be provided by the team, provision has been made for training a number of Saudis in the Kingdom and in the United States.

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13. Electrical services projects

A comprehensive 25-year electrification plan for the entire Kingdom has been completed and will be formally presented to the Ministry of Industry and Electricity in Riyadh late in November. Projects in the electrical field have also provided extensive advisory services and procurement assistance to the Ministry of Industry and Electricity, the Riyadh Electric Company, and the Nasseriah Power Station of the Ministry of Finance and National Economy. After completion of nearly all elements of the electrical procurement and installation project, a contract has been signed for substantial additional work at the Nasseriah Power Station.

14. National highway program

Seven U.S. professionals from the Department of Transportation Federal Highway Administration are now in Riyadh working with the Ministry of Communications in transportation-related areas such as highway design and maintenance, traffic safety, bridge structure and maintenance, and overall highway planning. Five additional team members are expected to arrive before the end of the year, bringing the total team size to 12.

15. New projects

New project agreements were signed in the following areas:

1. *Technical cooperation in transportation.*—A project agreement signed at the Joint Commission meeting provides for technical cooperation between the U.S. Department of Transportation and the Saudi Ministry of Communications in the transportation field. A team composed of eight Department of Transportation specialists will be assigned to work with the Ministry of Communications to develop a strong organization capable of guiding and monitoring the creation of a national system of public transportation.
2. *Agricultural Bank.*—A second project agreement signed at the meeting provides for technical cooperation in assisting the Saudi Arabian Agricultural Bank to modernize its administrative and operational functions. It was agreed that nine American professionals would be assigned to work with bank officials and that a number of bank employees would be sent to the United States for training.
3. *Executive management development.*—A third agreement establishes a new program under which selected senior Saudi Government administrators will participate in a management development program in the United States. The program will provide an opportunity for American and Saudi public service administrators to meet and exchange views on professional issues of mutual interest.

16. New areas for cooperation

1. *Health manpower development.*—An initial team of U.S. specialists in the public health area is expected to go to Riyadh in the near future for discussions with representatives from the Ministries of Health, Planning and Higher Education.
2. *Assistance to King Faisal University.*—A four-man team of educational specialists met with King Faisal University officials to assess university curricular and physical plant plans in the areas of agriculture, veterinary science, and medicine. The team is completing a report recommending the establishment of appropriate programs in these disciplines at new university campuses planned at Dammam and Hofuf. The report also will cover longer term assistance in the areas of planning and administration.

17. United States-Saudi Arabian business cooperation

The United States and Saudi Arabia agreed, during a meeting between Minister of Commerca Solaim and Secretary of the Treasury Blumenthal, to expand their already close bilaterial trade and business ties through increasing the flow of information between both countries on the requirements of the Saudi economy, on appropriate U.S. suppliers of goods and services, and on mutual trade problems and policies. It was further agreed that the interests of both governments lie in encouraging and

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facilitating private sector contacts in both countries through expanded trade promotional efforts and by the exchange of information and views through trade associations in both countries.

Overall assessment

The Commission considered the fourth session, with its accent on future objectives rather than past accomplishments, to have been the most successful to date. The three new agreements signed during the session bring the number of active project agreements to 20. It was noted that these programs represent positive contributions to the ever closer U.S.-Saudi Arabian bilaterial economic and commercial relationships.

The Commission thanked all participating Saudi Arabian ministries and American departments and agencies, as well as the private sectors in both countries, for their outstanding efforts and directed them to continue mutually to explore possible new areas of cooperation.

The cochairmen agreed to hold the next Joint Commission meeting in Washington, D.C. in 1979.

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Exhibit 45.—Excerpt from remarks by Secretary Blumenthal, January 15, 1979, at the Economic Councils Meeting, Department of State, Washington, D.C., concerning new U.S. economic ties with China and continuing economic ties with Taiwan

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At this historic time in our relationship with China, when we have normalized our political relationship, we now have the equally challenging task of normalizing our economic relationship. You have all heard Secretary Vance's description of how these events unfolded and what it means to us politically. It is our task—yours as businessmen and mine as a government official—to complete this process on the economic front.

China's ambitious economic goals to spur modernization, and her recent liberalization of foreign trade and finance policies, have marked an "opening to the West" which has invited Western governments and private industry alike to take advantage of its numerous commercial opportunities. We have gotten off to a late start in this game, but we now have the opportunity at least to begin making up lost ground.

Obviously we still have many obstacles to overcome. A normal economic relationship between China and the United States is hindered by such issues as the claims/assets problem, and absence of MFN and credit facilities. In the coming weeks and months we will be addressing the entire range of our bilateral economic relationship—not only the issues I have just mentioned but other important issues, indeed the whole range of issues that form the basis of an economic relationship between two nations.

These questions involve a whole host of complicated legal and legislative issues. The settlement of the claims issue in particular will require some time and careful consultation with the Congress as well as the Chinese. Our goal is to accomplish appropriate compensation for our claimants. This will take time and will require patience. Nevertheless, I am encouraged by the responses I have met so far and am optimistic of the eventual outcome.

In striving for the normalization of trade with China, the administration realizes the need for balance in its relations with others. The present legislation that governs the granting of most-favored-nation status to all nations must be applied evenhandedly; we cannot afford to improve relations with one trading partner at the expense of a deterioration of relations with another. The United States needs to expand its exports to all countries. We are striving to reduce our balance of payments deficit and to fortify the U.S. dollar. And to this end, we need your help. The American business community needs trade; the Carter administration wants it. We can ill-afford to cast a blind eye to the vast potential for exports provided by the Chinese, the Soviet, or any other market, as long as those exports take adequate account of our legitimate national concerns.

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It is to expedite the development of an economic relationship with China—as well as to participate in the first official exchange of ambassadors—that President Carter has asked me to lead a delegation of our top finance and trade people to Peking in late February.

My trip is part of a comprehensive and coordinated effort. Vice Premier Teng visits the United States at the end of this month. In providing the opportunity to exchange preliminary views on our future economic relationship, his visit here will form the basis for my trip. Hopefully this will lead to substantial progress towards a claims/assets settlement and a dialog on broader economic matters while I am in China. We would anticipate continuing this dialog after my trip. Secretary Kreps, who will go to China in late April, will pick up the ball at that point, continuing and initiating new discussions on trade and commercial matters.

While moving forward with our new economic ties with the People's Republic of China, I want to assure you that our commercial commitments with Taiwan have had our highest priority. These are essential. The administration's fundamental aim is to ensure continuity, stability, and growth in these economic ties, which now encompass over $500 million of U.S. private direct investment and roughly $7 billion in two-way trade. The Presidential memorandum issued on December 30 provides for the continuation of all current programs, agreements, and arrangements with Taiwan, and we will introduce legislation to make provision for the continuation of unofficial relations.

Taiwan is one of the most striking examples in the world today of successful rapid economic development. This very impressive growth has been achieved through the efforts of a strong private sector and enlightened official policies. Thus, as other important trading partners have shifted diplomatic recognition from Taipei to Peking, trade and other commercial relations with Taiwan have continued to flourish. There is every reason to expect economic relations between the United States and Taiwan will continue to expand.

We are entering a dramatic and exciting new era in our China relationship. The opportunity is before us to create new and vital economic ties with a China that is bent on entering the front ranks of the world's economic powers by the end of the century—and at the same time expand our commercial ties with the prosperous and thriving economy of Taiwan. As long as we approach this opportunity realistically, work together, and help each other in support of common goals, I am confident we will succeed.

Exhibit 46.—Excerpts from remarks by Secretary Blumenthal, February 2, 1979, before the Los Angeles World Affairs Council, concerning international trade.

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Trade is more important to the U.S. economy than most Americans realize. And it is becoming increasingly more important. In 1970 trade—our exports plus our imports—accounted for 8 1/2 percent of our gross national product. In 1978 it accounted for 15 percent. We know what the economic benefits of trade are. We depend on imports for essential raw materials; for a wide range of choice in consumer goods; for needed domestic competition and a spur to more efficient production; and as a source of jobs in import-dependent industries. And we depend on export markets as a means of selling a growing share of our national production; for jobs; and—as we are finally beginning to realize—to pay for our imports.

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In 1977 and 1978 we ran record trade deficits of $31 billion and $34 billion, respectively. The outlook for 1979 is for improvement: Our trade deficit will move closer to $27 billion. But though some significant improvement is clearly in sight, the basic problem remains. We can and must do more to reduce our trade imbalance. We cannot continue to run deficits of these magnitudes and expect to maintain confidence in the dollar, or combat inflation, or enjoy continued solid growth of our own economy.

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Improving our export performance

The Government and the business community must work as partners toward improving our competitiveness in world markets. Let me review what I consider to be the four key areas where work is needed.

- *First,* we must develop an "export mentality" throughout the business sector;
- *Second,* we must succeed in gaining a larger share of the important Japanese market;
- *Third,* we must overcome the low rate of growth of U.S. productivity of recent years;
- *Fourth,* we must take advantage of new markets as they become accessible in the LDC's and other developing countries like the Soviet Union and the People's Republic of China.

First, let's look at our export mentality. The industries which are now engaged in exporting are primarily the "giants." Reginald Jones, the chairman of General Electric, told me recently that his company alone contributes $2 billion net to our balance of trade. But smaller firms have not been as active, in part due to the high initial costs of entering foreign markets, and in part because they have concentrated on production for the domestic economy. And too, the route to the top of the corporate ladder is rarely through the international side, even in the largest corporations. There is little incentive for executives to think exports.

It is natural that U.S. producers concentrate their sales effort on the U.S. market. Foreign producers do, too. They find that the huge and dynamic U.S. market is a profitable place. So they make a special "export model" just to sell in the United States. But not many U.S. manufacturers will make a special model to sell in Japan—or in Europe, or in Brazil and other developing nations. Consequently, we have often failed to take foreign market tastes, preferences, specifications, and opportunities into account in the design and production of U.S. goods.

The U.S. industry has also become accustomed to highly sophisticated distribution and sales systems. But in many foreign economies, exporters still face "mom and pop" stores and inefficient distribution systems that are designed for small volumes. Inventory management and distribution networks are far more complicated. Unusual effort must be put into studying and working these markets. Corporations that focus on short-term earnings per share often find these startup expenses to be onerous.

There may be a good bit more we can do, both through the public and private sector, to improve our export mentality. The Government must learn to work for, rather than against, the interests of exporting businesses. The U.S.-Japan Trade Facilitation Committee, inaugurated in October 1977, exemplifies the kind of effort needed to improve information about what we have to sell, what foreigners want to buy, and to provide a forum for examining particular trade problems. But we still need export-minded firms to take advantage of these new efforts on the part of the Government.

I can point to Japan as a case where American corporations could do more than they realize. The Government of Japan does inhibit imports in many ways quite inappropriate for their type of advanced economy. U.S. exports to Japan are still limited by residual import quotas on agricultural goods; by high tariffs on a range of manufactured goods; by deliberately protective tariffs in such important sectors as computer equipment, film, photographic equipment, and some semiconductors; by lengthy approval procedures for imports of manufactured goods; by government procurement rules with a strong "buy Japan" tilt; and by special import restraints for politically sensitive industries.

A number of these problems have been discussed within the multilateral trade negotiations, and we hope to secure a substantial liberalization in some of these areas. But more liberalization is needed from the Japanese Government. The Carter administration and the Congress are determined to continue working with the Government of Japan to assure that their market—particularly for manufactured

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goods and the agricultural products with which the United States is especially competitive—is as accessible to us as ours is to the Japanese.

But we must also acknowledge that American corporations have themselves been slow in realizing that Japanese import barriers have already begun to weaken. Japanese markets for many modern manufactures, for example, are largely open to foreign competition. The concept of "Japan, Inc." is losing relevance as markets for basic and semiprocessed materials are opened to import competition. Yet the U.S. share of most export markets in Japan has been shrinking for a number of years. Japan is an example of where a "can't do" mentality hurts us. Businessmen from other countries face the same barriers to marketing in Japan as we do. But they have increased their market shares at our expense. The U.S. share of consumer nondurable imports by Japan, for example, fell from 32 percent in 1968–70 to 13 percent in 1976–77; from 40 percent to 27 percent for consumer durables; and from 61 percent to 51 percent for capital equipment.

American exports to Japan will not improve simply because the Japanese remove trade barriers. In Japan, as elsewhere, competitors from the Pacific basin, Latin America, and Western Europe will rush in as barriers come down. To outperform this competition, we will have to overcome our low rate of productivity growth.

U.S. output per man-hour in the manufacturing industries increased only slightly more than 25 percent between 1970 and 1976, while Japanese productivity grew by more than 50 percent, and German, French, and Italian productivity grew by more than 35 percent. Last year, American manufacturing productivity grew an abysmal 0.8 percent.

Many factors determine the rate of growth of labor productivity. One of the most important of these is the rate at which we expand our capital base. The stock of productive capital per worker increased every year in the postwar period up to 1974. Since then, the process of capital accumulation has come to a complete halt.

There are many reasons for this: Declining real profit margins, uncertainties about energy costs and availabilities, excessive regulation. We have taken steps to remove these roadblocks.

Our anti-inflation program will help restore after-tax real profits. A stronger dollar will enhance the environment for portfolio investment. Our recently enacted tax program should also assist investment through a cut in the corporate rate, a reduction in capital gains taxation, and an improved investment tax credit. These initiatives should result in a net reduction of some $7 billion in taxes on income derived from capital investment. The energy legislation enacted by the last Congress will work to eliminate uncertainties about the supplies of energy, particularly natural gas.

It is remarkable how, with the enactment of one bill by Congress, a permanent geological scarcity can suddenly turn into a glut of natural gas—at least temporarily. Perhaps we can find a formula for doing the same for crude oil.

Finally, investment should benefit from our efforts to get control of the unnecessary preempting of resources by regulatory authorities. The Carter administration is the first administration ever to institute an internal program for a cost-benefit assessment of individual regulations. The costs are staggering. We intend to pare them down.

Still, more must be done to stimulate R. & D. and increased productivity. I would welcome any suggestions you might have as to how.

A fourth area where we need to make a special effort is in exploiting new markets. I needn't say much on this commonsense subject. The developing countries obviously provide a great opportunity. And the Soviet and Chinese markets must not be neglected.

U.S. exports to the Soviet Union have quadrupled to $2.2 billion since we signed our first major trade agreement with them. But most of this total is agricultural goods. We only exported some $500 million in manufactured goods to the U.S.S.R. last year. This compares with manufactured exports of nearly $3 billion by Germany, $2 billion by Japan, $1½ billion by France, and $1 billion by Italy. The opportunities for the United States are self-evident.

Obviously, the United States will not export goods to the U.S.S.R. which are of strategic consequence. However, in the nonstrategic, non-defense-related areas where the Germans and others have been doing a better job, the potential is considerable.

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As for China, normalization offers a great deal. China's ambitious economic goals to spur modernization, and her recent liberalization of foreign trade and finance policies, have marked an "opening to the West." We have gotten off to a late start in this game. Now we have the opportunity to begin making up lost ground.

We still have many obstacles to overcome. We have yet to put in place the basic arrangements needed for the conduct of a normal trading relationship between our two countries. There is no civil aviation agreement. There is no shipping agreement. We have no trade agreement with the Chinese. And in striving to put these arrangements in place, we must overcome the obstacles posed by the need to settle the claims/assets issue, the absence of most-favored-nation status, and the lack of official credit facilities.

The Chinese market is vast. Trade between the United States and China increased twofold in 1978 to approximately $1 billion. Again, much of this is agricultural trade and much, much more can be done on the industrial side. The potential is there. But it will take time to materialize; the process will be a gradual one. The Chinese need to develop improved means of financing purchases. They need to put in place the facilities like housing and American consular offices that are needed to support American businessmen. And the facilitation of business applications by the Chinese bureaucracy will have to be further rationalized.

The administration will be working hard in the coming weeks and months, together with the Chinese, to pave the way for American corporations to do business in China.

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Exhibit 47.—Excerpts from remarks by Assistant Secretary Bergsten, March 7, 1979, before the Symposia Society of America, Washington, D.C., entitled "Toward Fairer International Trade: The New Subsidy/Countervailing Duty Code"

The problem of defining what is fair and unfair in international trade has been at the root of some of the most difficult, and contentious, issues in international economic relations in recent years.

- The few accepted international rules we have had to guide us have been poorly implemented.
- Increasing governmental involvement in economic affairs, in both the industrialized and developing countries (LDC's), has compounded the critical importance of finding new ways to define "fairness" and deal effectively with unfair practices.
- Subsidy/countervailing duty problems, in particular, have threatened to undermine overall international relations and prevent cooperation in other areas.

The United States therefore made the conclusion of a code on the use of government subsidies and countervailing duties its top priority in the multilateral trade negotiations, and a prerequisite to U.S. adherence to any final package of agreements. As a result, the new subsidy/countervailing duty code which has been negotiated in Geneva offers a very important step toward better definitions and improved enforcement against unfair practices in the subsidy area.

Today, I would like to discuss why we consider a subsidy/countervailing duty code so essential, our objectives in negotiating such a code, and the principal elements of the code which has been negotiated. I will focus on the benefit for the United States which will derive from the code, and why I believe that congressional approval of the code—as part of the overall MTN package—is essential for the United States.

Subsidy problems

Subsidies have become an increasingly important tool of national economic policy in all nations. They have long been considered critical to development in the LDC's. But the tendency to subsidize has also been accelerated in virtually all industrial nations in recent years as a result of slow economic growth, high unemployment, and strong import competition.

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Subsidies are frequently used to help maintain employment, improve industrial efficiency, and stimulate research and development. Unfortunately, they can also become a means of avoiding necessary adjustment to changing global trade patterns.

We can't eliminate subsidies entirely. But we can, and must, seek to set guidelines for the use of subsidies which adversely impact on international trade. The crucial principle is simple: *Countries cannot be permitted to export their own problems to other countries via export or even "purely domestic" subsidies.* Whether such subsidies are explicit aids to exports or directed in the first instance to domestic production, the critical test is whether they cause or threaten injury to foreign producers or seriously prejudice the reasonable expectations of foreign exporters regarding access to domestic markets.

The use of countervailing duties (CVD's) is closely linked to the problem of subsidies. By their nature CVD's are both a tool of economic policy and a political response to the economic programs of other countries. Yet if we cannot agree on which subsidies are "fair" and which are "unfair," we clearly will not agree on when and how much in the way of offsetting countervailing duties are legitimate.

Improved discipline on the use of subsidies and countervailing duties is therefore essential:

To avoid injurious trade distortions;

To "defuse" potentially explosive trade problems which threaten overall international relations; and

To assure more rapid procedures for the resolution of subsidy/CVD disputes.

Objectives in the MTN

The Trade Act of 1974, the congressional mandate for U.S. participation in the multilateral trade negotiations, urged the President to "take all appropriate and feasible steps within his power (including the full exercise of the rights of the United States under international agreements) to harmonize, reduce, or eliminate barriers to (and other distortions of) international trade." The term "distortion" specifically includes the use of subsidies (section 102 a and g). The act also requested the President to update current international agreements, making "any revisions necessary to define the forms of subsidy to industries producing products for export and the forms of subsidy to attract foreign investment which are consistent with an open, nondiscriminatory, and fair system of international trade." (Section 121.)

We have substantially met these requirements of the Trade Act through the new code. We sought as major components of this code:

- A reinforcement of the commitment already accepted by most industrial countries not to use export subsidies for industrial products, plus staged expansion of that commitment to LDC's.
- New international discipline to guard against the disguised protection of domestic markets through internal or production subsidies.
- Improved discipline over subsidized competition in agricultural products in third markets.
- Concomitant guidelines on the use of countervailing duties, which would recognize that such duties should be applied only when a subsidy threatens or causes injury to a domestic industry.
- Prompt recourse to other countermeasures if specific commitments regarding the use of subsidies have not been fulfilled.
- Effective implementation of rules on both subsidies and countervailing duties, and strengthened provisions on dispute resolution.
- Acceptance by advanced developing countries of increased obligations on subsidies as their industries become internationally competitive.

The new code

We have been successful in obtaining new guidelines for the use of subsidies and countervailing duties in virtually all of these areas. The code spells out specific rights and obligations for all signatories on both subsidies and CVD's and * * *

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* * * offers the United States a number of new specific benefits:

1. We have a *much stronger prohibition of industrial export subsidies,* complemented by an updated list of prohibited export subsidy practices. This new list includes such practices as export inflation insurance, exchange risk guarantees, and duty drawbacks in addition to items carried over from the previous GATT list.
2. Explicit recognition that *countries must accept responsibility for the trade effects of their domestic subsidy programs,* and express commitments that they will *avoid granting such subsidies that adversely affect the trade interests of other countries.*
3. *Domestic subsidies which impair GATT tariff bindings through import substitution are subject to countermeasures* as a violation of GATT commitments. Such subsidies may include, but are not limited to, regional development grants, research and development grants, government provision of infrastructure services, and government financing of commercial enterprises, including provision of loans and guarantees on noncommercial terms.
4. *Export subsidies* on industrial products *to third markets are subject to countermeasures,* as are export subsidies on agricultural products which displace the exports of others or involve material price undercutting in a particular market.
5. The code permits for the first time the use of *provisional measures before the application of countervailing duties.* Provisional measures may be applied after a preliminary subsidy determination, for a period of up to 4 months.
6. *Developing countries for the first time are agreeing to phase out the use of export subsidies* as part of their obligations, commensurate with their competitive needs, under the new code. This is especially important to a number of U.S. industries which face import competition from highly subsidized exports from Brazil, and from other developing nations which we expect to join the code.
7. We have an improved framework for conducting domestic countervailing duty investigations. *U.S. industries will have a clearer idea of what is required to prove injury, more certainty in proceedings, and consistency in application of the injury test.*
8. *New procedures should shorten somewhat the time required for investigation and application of final countervailing duties.*
9. Finally, tight deadlines (a maximum of 150 days) on the dispute resolution process assure *prompt international review of subsidies which violate code or other GATT commitments.*

These are substantial benefits for the United States. Our agreement in return, to adopt an injury test in our domestic law, is a fair deal and makes sense for U.S. producers and consumers alike. We are convinced that the code provides a much more effective basis for the resolution of international subsidy problems than has existed in the past, or could possibly exist in the future without the code. It is an essential component of the package of agreements we have achieved as part of the multilateral trade negotiations to deal with the major trade problems of the 1980's.

Exhibit 48.—President Carter's Report to the Congress, March 16, 1979, regarding progress in negotiating on export credit financing

The Export-Import Bank Act of 1945 as amended in November 1978 (Sec. 1908(a) of Public Law 95–630) requested me "to begin negotiations at the ministerial level with other major exporting countries to end predatory export financing programs and other forms of export subsidies, including mixed credits, in third country markets as well as within the United States." The legislation called for a report to the Congress on progress toward meeting these goals.

As I indicated on September 26, 1978, in my Statement on Export Policy, this Administration attaches high priority to increasing American exports. The Export-Import Bank plays a very significant role in that effort. Accordingly, this Administration has sought to make the Bank's financing more competitive with the official export financing provided by other governments and, at the same time, to improve the International Arrangement on Export Credits so as to avoid costly and self-defeating export credit competition between sovereign governments.

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I directed the Secretary of the Treasury to undertake the appropriate negotiations. In fact, Secretary Blumenthal had already alerted foreign governments to the need for a broadened and strengthened International Arrangement at the OECD Ministerial Meeting in June 1978 and the issue was again raised at the meeting which prepared the agenda for the Bonn Summit. In September 1978, Secretary Blumenthal emphasized to the Finance Ministers of our major trading partners the importance of substantive improvements in the International Arrangement on Export Credits. He presented detailed proposals designed to bring the financing terms set forth in the Arrangement closer to worldwide commercial practices and to broaden the Arrangement to cover sectors presently excluded from coverage.

Briefly, these proposals called for increases ranging from ½ to ¾ of one percent in the minimum interest rates called for by the Arrangement, the elimination of local cost support by export credit agencies, and greater restraint in the use of highly concessional mixed credits. In addition, maximum repayment terms and minimum interest rates were proposed for aircraft, nuclear power plants and liquefied natural gas (LNG) tankers, sectors presently excluded from the Arrangement. Similarly, a proposal was made to have the Arrangement cover credits for agricultural commodities in excess of three years but not more than ten years. Additional possibilities for improving the Arrangement emerged during the subsequent discussions.

These proposals were presented to the twenty-two countries participating in the International Arrangement on Export Credits for consideration at their October 1978 meeting. At our urging, these countries agreed to establish a working group to consider improvements in the Arrangement. The working group met in December 1978 and in January 1979. In addition, representatives of the U.S. Government discussed these proposals at length in bilateral meetings with other governments.

Although the substance of our proposals appeared to constitute a basis for negotiation, the required unanimity for the changes we sought in the Arrangement was lacking. As a result, no agreement regarding modifications in the Arrangement acceptable to the U.S. Government could be reached.

I have therefore reluctantly concluded that further negotiations would not be productive at this time. If the countries which have opposed the improvements we have suggested evidence their willingness to be more forthcoming, I would be prepared to resume negotiations at any time.

For the present, however, the lack of progress requires us to reexamine our own efforts to assure that we remain competitive in the export credit field. Our examination may well indicate that we should modify some of our own programs and policies until such time as there is more willingness among our trading partners to impose the needed self-discipline on export credit practices.

Meanwhile, the United States will continue to adhere to the International Arrangement on Export Credits because it remains a useful, if limited, instrument of international discipline in the provision of officially supported export credits. Within this framework, the Export-Import Bank, operating in consultation with the National Advisory Council on International Monetary and Financial Policy (NAC), will provide the necessary export financing support to allow American exporters to meet foreign official export credit competition. For example, Eximbank will continue its recently adopted policy of matching mixed credits on a selective basis, a policy which proved effective recently when an American exporter was awarded a contract based on an Eximbank financing package that matched the mixed credit offer of a foreign government.

Finally, in my FY 1980 budget, I have asked the Congress for $4.1 billion in direct lending authority for Eximbank, an increase of $500 million from the FY 1979 budget. I have asked for this increase, together with $6.8 billion in insurance and loan guarantee authority, in a year in which I am determined to cut the Federal budget deficit to below $30 billion. I expect the Bank to husband these new resources carefully, but I also expect the Bank aggressively to meet official export credit competition.

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The attached annex details the discussions and the actions taken to improve the International Arrangement and provide competitive official export credit financing.

JIMMY CARTER.

THE WHITE HOUSE,
March 16, 1979.

Annex

Detailing U.S. Government Actions to Improve the International Arrangement on Export Credits and Provide Competitive Official Export Credit Financing

Background

Consistent with the legislative mandate contained in Section 2 of the Export-Import Bank Act in 1977, the U.S. Government proposed new negotiations to create a firmer set of international guidelines to minimize the subsidy elements in officially supported export credits. Certain ground rules had existed since 1976 when some of the major OECD trading nations agreed upon an "Export Credit Consensus". However, the generality of the Consensus and the absence of a uniform text made further definition and improvement desirable to prevent uneconomic allocation of resources, budgetary waste and the political frictions which inevitably accompany excessive international economic competition among governments. After an intensive series of meetings, agreement was reached on a new International Arrangement on Export Credits. The Arrangement came into effect on April 1, 1978, with 22 participating countries.

The strength of the Arrangement lies in a detailed statement of procedures designed to enable each export credit agency to operate on the basis of greater knowledge about the credit offers of its competitor agencies in other countries. Although the system is not flawless, the resulting "transparency" has been an important factor in alleviating an escalation of export credit terms. Any country now has a greater opportunity to match, on a timely basis, excessively concessional offers of another participant—hence deterring such offers.

In addition, the Arrangement codified the minimum export credit terms which would normally be offered by each export credit agency. These minimum terms and other key features of the Arrangement are:

1. A cash payment of at least 15 percent of the export contract value is required.

2. Repayment terms cannot exceed 8 ½ years for relatively rich countries and intermediate countries, and 10 years for relatively poor countries. The repayment of official export credits should normally be in equal and regular installments, payable not less frequently than every six months.

3. In the case of direct or re-financed loans by an export credit agency, the minimum interest rate, exclusive of insurance premiums and bank fees, ranges from 7.25 percent to 8.00 percent based on the number of years in the repayment period and the classification of the country receiving the credit (i.e. relatively rich, intermediate, or relatively poor country). In the case of "pure cover"—that is, official support limited to an export credit guarantee or insurance—no minimum interest rate is prescribed since the credit itself is provided by the private banking system at commercial rates.

4. Interest is normally payable not less frequently than every six months during the repayment period, whether official support takes the form of a direct loan or "pure cover".

5. The financing by export credit agencies of local costs connected with an export project (that is, costs incurred in the borrower's country such as labor or construction costs) cannot exceed the cash payment on the associated exports.

6. Prior export credit commitments not in conformity with the Arrangement must be reported under a defined procedure. Similarly, the procedure for reporting derogations (breaches of the Arrangement guidelines) and matching offers by other export credit agencies are set out in detail.

7. Excluded from coverage under the Arrangement are export credits for military equipment, agricultural commodities, aircraft, nuclear power plants and liquefied natural gas (LNG) ships. OECD "Standstill" agreements impose some limits of a less precise and less strict nature than those contained in the Arrangement, on the export credit terms available for aircraft and nuclear power plants. An OECD Understanding

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also limits export credit terms for most ships. Because the United States is not a party to that Understanding, we have agreed to apply the Arrangement terms to ships other than LNG tankers and to notify the participants if we offer terms for LNG tankers which are more favorable than those permitted by the Arrangement.

8. The Arrangement does not prohibit mixed credits, cost inflation risk insurance or exchange risk insurance.

Mixed credits are credits which combine "tied" aid financing on highly concessional terms with export credit financing. The Arrangement requires prior notification of a mixed credit offer when the "grant element" of the combined credit is less than 15 percent. When the grant element is between 15 and 25 percent, prompt notification is required after an offer is made. (The "grant element" measures the concessionality of a credit, using a 10 percent discount factor. Most official export credits contain some grant element, but normally less than 15 percent.)

Export inflation insurance compensates the exporter when the cost of producing the goods or services rises above a specified level because of inflation. Exchange risk insurance compensates the exporter when the exporter accepts payment in a currency other than his own and the value of that currency decreases below a specified level.

The United States presently does not offer export inflation or exchange risk insurance.

9. The Arrangement will be reviewed by the Participants at least once a year. The first review was held in October 1978 and the second review is tentatively scheduled for May 1979.

10. Withdrawal from the Arrangement requires not less than 60 days' notice; otherwise, there is no termination date.

Need for improvement

In testifying before the Congress earlier in the year on the extension of the Eximbank charter, Administration witnesses emphasized that the International Arrangement on Export Credits was a useful forward step. Nevertheless, it had major weaknesses: (1) the element of subsidy in official export credit financing was not significantly reduced; (2) important sectors continued to be excluded from coverage; and (3) certain commercially unsound practices were not dealt with. It was anticipated that the shortcomings in the Arrangement would be addressed in the fall 1978 review of the operation of the Arrangement.

It was hoped that our major trading partners would see the importance of reaching agreement on firmer ground rules on the use and discipline of export finance. The Congress expressed its interest in an improved Arrangement when it passed the "Export-Import Bank Act Amendment of 1978". Section 1908(a) requested the President "to begin negotiations at the ministerial level with other major exporting countries to end predatory export financing programs and other forms of export subsidies, including mixed credits in third country markets as well as within the United States." Further, it called on the President to report to the Congress on progress toward meeting the goals of this section. As a part of his September 1978 Statement on U.S. Export Policy, the President directed Secretary of the Treasury Blumenthal to undertake immediate consultations with our trading partners to expand the scope and tighten the terms of the existing International Arrangement on Export Credits.

Secretary Blumenthal stressed the need for action in a letter to the Ministers of Finance of the major trading countries. He made specific proposals designed to achieve greater discipline over the subsidy element in much official export credit financing.

Secretary Blumenthal met with Finance Ministers during the annual meeting of the International Monetary Fund/World Bank at the end of September 1978 to emphasize the importance of successful negotiations to improve the Arrangement. Other U.S. Government officials pushed to accelerate the pace and bring participants to the negotiating table. Representatives of the European Economic Community (EEC) and its member states came to Washington to further explore these issues.

In October 1978, Assistant Secretary of the Treasury C. Fred Bergsten and John L. Moore, Jr., President and Chairman of the Export-Import Bank, visited key European countries to discuss the U.S. proposals with senior policy officials in those countries.

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Teams of U.S. Government officials went to Tokyo and to Ottawa in October to explain to senior government officials the proposals set forth in Secretary Blumenthal's letter to the Finance Ministers. U.S. Government officials went to Brussels twice in 1978 to discuss with the European Economic Community possible improvements in the Arrangement involving some of the excluded sectors.

The U.S. proposals were discussed at meetings of all the participants in the Arrangement in October 1978 and in January 1979. Although there was support for various aspects of the U.S. proposal from many countries, others, including the European Economic Community, had serious difficulty with them. The EEC stated that it had no "mandate" from its Council of Ministers to negotiate any issues except the excluded sectors.

U.S. proposals

The proposals submitted to the twenty-two participating countries as a basis for negotiation, as subsequently modified and extended during the course of discussions, called for improvements in four basic areas:

1) An increase in the minimum interest rates of the Arrangement (which vary according to length of repayment period and classification of country) ranging from $^1/_2$ to $^3/_4$ of one percent, and two related proposals to update the country groupings and eliminate export credit subsidies on sales to European Community markets;

2) An end to official support for "local costs";

3) Moderation in the use of mixed credits by limiting such financing to the very poor countries and by increasing the element of "transparency" through prior notification of all mixed credit transactions; and

4) Coverage in the Arrangement of sectors presently excluded, namely agriculture, aircraft, nuclear power plants and ships.

Interest rate proposals

With a few exceptions, market interest rates in most participating countries are above the levels that existed in 1976 when the first Consensus on export credit was adopted and the minimum interest rates were established. Accordingly, the United States argued there was strong justification for higher minimum interest rates on direct loans by official export credit agencies.

Some countries pointed out, however, that interest rates were falling or were relatively constant in countries such as Germany, Switzerland and Japan, even though interest rates had risen in the United States and most other countries. These countries felt, therefore, that an increase in the interest rate minimums applied to direct loans was not justified.

Some countries also maintained that a higher schedule of minimum interest rates on direct loans would adversely affect their export competitiveness since the understanding is that minimum interest rates in the Arrangement do not apply to cases where the only official export credit support is "pure cover", that is, insurance or guarantees of private loans against commercial or political credit risks. The exclusion of "pure cover" from the minimum interest rate schedule permits countries with low rates of inflation, and hence low commercial interest rates, to offer simple guarantee or insurance programs where the credit itself is provided by the private banking system and thus contains no element of interest rate subsidy.

Countries with low commercial interest rates (Germany, Switzerland, and Japan) can therefore offer lower interest rates (so long as they limit their official support to "pure cover") than other countries which offer direct export credits. This interest rate difference would be increased if the minimum interest rates on direct loans were raised.

In response to these concerns, the United States expressed the view that it was not normally the function of official export credit agencies to offer below-market rate loans in one currency to match the lower market rate loans extended in the currencies of countries with lower inflation rates (e.g., Germany, Switzerland or Japan). In addition, where a guarantee or insurance is provided for a transaction together with exchange risk insurance, the U.S. view was that the financing package must conform to the terms of the Arrangement.

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To address these problems, the United States proposed that the minimum interest rates provided in the Arrangement should also apply to transactions receiving "pure cover" if official exchange risk cover was also provided.

The Participants did instruct the OECD Secretariat, under the leadership of an experienced export credit official and with such expert assistance as he selects, to undertake a study of the appropriateness of the interest rate matrix taking into account, *inter alia,* varying rates of inflation, exchange rate movements and the disparity of interest rates for different currencies. Format and procedure for this study are to be completed in time for review at the annual Arrangement review meeting in May 1979. The final report is to be completed by the end of 1979, if possible, and no later than May 1980.

Country graduation

The progress in economic development and per capita income in some of the countries originally classified as "relatively poor" suggests that they should be reclassified to the status of "intermediate" countries, and thus receive slightly harder export credit terms. While there was recognition of the point by some participants, many felt no action should be taken at this time for the same reasons that they opposed a more general move towards higher interest rates on direct loans.

Elimination of interest rate support on sales to European Community countries

The United States proposed adoption by all participants of the European Community's own practice of permitting only "pure cover" (i.e. guarantees or insurance) on sales between the EEC countries. This would mean that all export transactions to the EEC countries—whether from the United States, Japan, the Nordic countries, or other sources—would be at market interest rates. This proposal was acceptable to the European Community itself, but attracted an adverse reaction from some of the other participants who believe they would lose a competitive edge in the EEC market.

Local cost proposals

Local cost financing constitutes support for goods and services obtained in the buyer's market and involves a domestic rather than a foreign exchange cost, hence it is not an export credit at all. The Arrangement presently permits local cost financing for an amount not exceeding the cash payment, that is 15 percent.

The United States contends that local costs should be financed independently of exports and that local cost support at favorable export credit terms generally amounts to a "sweetener" designed to influence the buyer's decision on the source of procurement. Nevertheless, some participants in the Arrangement are reluctant to restrict the financing of local costs. They assert that importing countries expect this form of support and it is politically difficult to terminate local cost financing.

Mixed credit proposals

Mixed credits are credits which couple tied aid financing on highly concessional terms with normal export credits. The "blended" terms can be well below the minimum terms set forth in the Arrangement. France, which is a principal provider of mixed credits, views this practice as an integral aspect of its concessional assistance to developing countries and states that its mixed credit transactions account for a very small part of its exports.

The United States and many other countries have responded that, whatever the size of the program, mixed credits constitute an unfair practice and should be moderated, if not eliminated. At a minimum, there should be prior disclosure of the offer of such credits.

Sector proposals

The sector discussions on ships and nuclear power plants focussed on the maximum length of the repayment term and the minimum interest rate. The U.S. position is that

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longer repayment terms, in the range of 12 to 15 years, are required by the economics of the projects involved in these sectors but that such longer terms should be accompanied by a higher interest rate (8.5 percent) to reflect normal commercial practices. Some other participants preferred a maximum repayment term of 10 years with no increase in interest rates.

In the case of commercial jet aircraft, the United States suggested a maximum repayment period of 10 years for both sales and leases, which would eliminate an important distinction between sales and leases. The United States also proposed an 8.5 percent minimum interest rate in this sector. While there were still some points at issue, such as the minimum interest rate level, agreement appeared close in this sector.

Discussions regarding the inclusion of agricultural commodities in the Arrangement were sparked by international concern over the authority granted by the Agricultural Trade Act of 1978 to the U.S. Commodity Credit Corporation to offer financing with a repayment period of over three years but not more than 10 years for certain agricultural commodities and facilities. Almost all agricultural commodities are now sold for cash or for short-term credit, reflecting the short useful life of such commodities.

Considerable concern was expressed that coverage of agriculture in the Arrangement, which deals with medium- and long-term financing, might imply that past normal commodity financing terms are being changed, thereby forcing all commodity exporting countries to provide longer term credits. Thus, several countries called for periodic reporting of transactions having a repayment term over six months or one year, to permit monitoring of the extent of any changes in commodity financing norms. Some countries also wanted prior notification when the repayment term was longer than two years. The U.S. position was that prior notification could be considered only for certain types of transactions with repayment terms over three years, since normal Commodity Credit Corporation financing often provides for repayment terms up to three years.

Conclusions

The U.S. Government has made every possible effort to obtain substantive improvements in the International Agreement on Export Credits. Time and again U.S. officials emphasized the international advantages of such improvements. It was clear that the proposals submitted by the United States were negotiable and that meaningful compromises were possible. It is the view of the United States that participants in the Arrangement, other than the European Economic Community, would probably have agreed to the main outlines of the U.S. proposals. Despite extensive effort on the part of all governments and frequent meetings. however, the wide differences between what the U.S. Government could accept and what the European Economic Community offered made further negotiations at this time a fruitless endeavor.

Considering the importance of increased exports to the United States, and the stalemate in the negotiations, it now appears that the only feasible course of action at this time is a re-examination of the export financing programs and policies of the United States to assure that we remain competitive. The Export-Import Bank, operating within the framework of the existing International Arrangement on Export Credits, will therefore provide aggressive export financing support to U.S. exporters.

Exhibit 49.—Excerpt from remarks by Assistant Secretary Bergsten, March 28, 1979, before the American Footwear Industries Association, Key Biscayne, Fla., entitled "Trade and the U.S. Economy"

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Trade with the developing nations

The developing countries are becoming increasingly important markets for U.S. exports. They accounted for more U.S. export sales in 1978 than Western Europe and Japan combined, representing 37 percent of all our exports—or $53 billion. Further-

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more, they are the fastest growing markets for our goods. Between 1970 and 1978, our exports to the developing countries grew by 340 percent, compared with a growth of 180 percent in our exports to developed countries. Even excluding the OPEC countries, U.S. exports to the developing countries grew by 270 percent—still far faster than those to the developed countries.

We expect these trends to continue into the future. The World Bank's World Development Report projects LDC imports of goods and services of $900 billion in 1985, compared with their actual 1975 imports of $270 billion. The reasons for this are not hard to find.

First, the developing countries are growing more rapidly than the rest of the world. Between 1960 and 1975, total production in these countries grew at an average annual rate of 5.6 percent, compared with 4.2 percent for the developed countries.

Second, these countries have an enormous need for the goods and services that will allow them to provide an acceptable standard of living for their populations. Particularly for machinery and other capital goods—the kinds of manufactured goods in which the United States has its clearest international advantage—the appetite of the developing countries over the longer term is potentially insatiable.

Nevertheless, the future of the developing countries and the extent of our exports to them depend crucially on their ability to export to us those products where they have a comparative cost advantage. Trade must be a two-way street.

As you are well aware, exports from the developing countries have become quantitatively important in some sectors, such as shoes and textiles. Some have implied that, because of our high-wage economy, U.S. industry cannot compete with producers in these countries. This is not the case, for high-wage workers in the United States are also high-productivity workers. For manufactured goods as a whole, the LDC's import much more than they export. In 1976, we and the other industrial countries imported $36 billion in manufactured goods from the developing countries, but we exported $124 billion worth of manufactures. Thus, the industrial countries had a trade surplus for manufactures of nearly $90 billion with developing nations.

In the case of the United States individually, we exported $2 worth of American manufactures to developing countries for every dollar we imported.

Unquestionably, the capacity of the developing countries to export manufactures will continue to grow. The World Bank projects an annual growth rate for export volume of 12 percent through 1985. Even at that time, however, developing countries will still be a relatively small force in comparison to imports from all sources—accounting for less than 14 percent of industrial country imports of manufactures and less than 3 percent of total domestic sales.

Those who call for generalized protection from imports must not ignore these realities. Efforts to artificially reduce imports from such countries will have two effects. First, it will invite retaliation against U.S. exports, putting at risk the millions of jobs now producing for the LDC market. Second, it would reduce the capacity of these countries to import, thereby slowing the growth of potential markets for American goods and costing American jobs. Both would adversely impact on our prosperity and standard of living.

Thus, continued access to our markets by the developing countries is essential both to our own interests and those of the world economy. Nevertheless, I want to assure you of our unyielding belief that such international trade needs to be conducted on a basis of fairness to all participants.

Fairness requires two main elements:

First, all countries must accept responsibilities consistent with the benefits they receive from a liberal international trading system. A few developing countries, notably including Hong Kong, South Korea, Taiwan, and Brazil, have emerged very rapidly as serious competitors to the industrial countries for a wide range of products. We have taken a strong stand in urging these advanced developing countries (ADC's) to liberalize their import systems and to assure that they accept the responsibilities consistent with their increasing role in world trade. We believe we have had a large measure of success, both in the multilaterial trade negotiations (MTN) and in bilateral discussions.

Second, the use of subsidies to promote export-led growth must be controlled. Clear limits on subsidies that influence international trade are essential, particularly to assure

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that countries do not use them in a way that harms other countries. Again, we have made a major effort in the MTN to assure consistent principles that would assure producers in all countries that they will not be hurt by unfair competition.

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Exhibit 50.—Remarks by Assistant Secretary Bergsten, April 30, 1979, before the Pennsylvania International Trade Conference, Hershey Park, Pa., entitled "The New U.S. Export Policy"

Both the U.S. Government and U.S. business as a whole are finally recognizing that exports are essential. They are essential to the overall strength of the U.S. economy. They generate a substantial number of jobs. And they are a significant element in determining the strength of the U.S. dollar.

Exports are clearly critical to both the U.S. private sector and to Federal Government economic policies:

Until a few years ago, the U.S. economy accounted for over 50 percent of the world economy; now, the market in the rest of the world is bigger than the U.S. market for virtually every industry.

Exports have been one of the fastest growing sectors of the U.S. economy. Between 1972 and 1976 total U.S. production of manufactured goods grew by 57 percent, while our exports of manufactured goods grew more than twice as fast. Agricultural exports during this period nearly tripled, as compared to a growth of about 70 percent for domestic agricultural production as a whole.

One out of every eight manufacturing jobs in this country produces for export. That's more than 2 million manufacturing jobs in the economy as a whole which depend on exports. For example, in 1976 exports accounted for:

- 63 percent of total U.S. production of oilfield machinery;
- 43 percent of U.S. production of construction machinery;
- 35 percent of U.S. aircraft production;
- 32 percent of U.S. production of turbines and turbine generators;
- 26 percent of all computers and related equipment we produce;
- 24 percent of U.S. pumps and compressors; and
- 18 percent of U.S. farm machinery.

One out of every 3 acres of American farmland produces for export. In fiscal year 1977 we exported:

- 60 percent of our soybeans and soybean products;
- 58 percent of our cattle hides:
- 58 percent of our almonds;
- 55 percent of our rice;
- 45 percent of our cotton;
- 40 percent of our wheat; and
- 30 percent of our tobacco.

Many jobs in the coal-mining and mineral industries, as well as a considerable number in the fishing industry, are dependent on overseas sales. Exports also support employment in the trucking, rail transport, insurance, and other service industries.

Almost one out of every three dollars of U.S. corporate profits now derives from the international activities of U.S. firms, including their foreign investments as well as their exports.

Pennsylvania, in particular, depends upon exports for more than $4.7 billion in sales of manufactured goods, $135 million in agricultural goods, and $345 million in mineral goods (all figures are for FY 1976 or FY 1977). This State is the Nation's seventh largest exporter of manufactured goods. More than 150,000 jobs in Pennsylvania are dependent upon exports of manufactured goods, about one of every nine manufacturing jobs in the State. Nonelectric machinery, electric equipment, and transportation equipment are Pennsylvania's largest exports, accounting for $2.6 billion in overseas sales in 1976. The State's manufactured exports doubled between 1972 and 1976, with about three-fifths of the increase in electric equipment production and a third of the

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rise in production of nonelectric machinery and transportation equipment due to exports. One of every 14 dollars in Pennsylvania farm sales also comes from exports.

In 1970 combined U.S. exports and imports accounted for 8½ percent of our gross national product. By 1978 the share of total trade in our GNP had nearly doubled to 15 percent—with a bit more than a 6½-percent share for exports and nearly 8½ percent for imports. This difference of almost 2 percent in our import and export shares accounts for our 1978 trade deficit of $34 billion. Although we don't need to eliminate this gap—which is paid for in large part by net exports of services ($23 billion in 1978)—we *should* reduce it substantially.

A healthy and expanding export sector is essential for the longrun stability of our external accounts and thus of the dollar. Indeed, increased U.S. exports are by far the most constructive response to our trade balance and dollar problems.

We have already seen significant improvement in our trade balance as export growth has increased. Over the past year, our trade deficit has been reduced by almost 40 percent. Indeed, between the first quarter and fourth quarters of 1978, the physical volume of U.S. exports grew at a 22-percent annual rate while the volume of imports rose at only a 1-percent rate.

During the third quarter of 1978, the U.S. share of world export markets for manufactured goods rose to 17.3 percent on a seasonally adjusted basis. This is more than a full percentage point above the first-quarter trough of 16.2 percent. It was the second straight quarter of improvement, and confirms that a reversal has taken place in the U.S. market position, which had been deteriorating since 1976.

Still more, however, needs to be done to increase U.S. exports—both to pay for our oil and nonoil imports and to benefit our economy as a whole.

Increasing U.S. exports

In recognition of the importance of exports to the U.S. economy, last year this conference urged the President to encourage the growth of U.S. exports through an active Export-Import Bank program, tax incentives similar to DISC, Commerce and State Department promotion programs, and the Tokyo Round of multilateral trade negotiations. You also called for reduced impediments to U.S. exports in such areas as the overseas application of antitrust laws, taxes on private sector employees based abroad, the prohibition of Eximbank credits for many markets, taxation of foreign manufacturing facilities owned by Americans, and embargoes on U.S. trade with selected countries.

Your proposals were given full consideration, along with suggestions from other U.S. industrial and trade groups, Congressmen, and others, in preparing the new U.S. export policy announced by President Carter in September 1978. At that time the President announced a number of new measures designed to stimulate increased exports. He expressed his commitment to this effort as a matter of high national priority.

The new U.S. export policy aims to: (1) provide increased direct assistance to U.S. exporters; (2) reduce domestic barriers to exports; and (3) reduce foreign barriers to our exports and secure a fairer international trading system for all exporters. The U.S. Government has taken a number of steps to further these goals, and I would like to summarize these for you shortly.

We fully recognize, however, that exports cannot be increased in a vacuum, without regard to the broader macroeconomic situation in the U.S. economy and in the world as a whole. If domestic inflation is too high, relative to inflation overseas, U.S. products will be priced out of foreign markets. If the productivity of U.S. industries is stagnating, while productivity abroad is increasing rapidly, we will not be able to maintain our competitive edge, either at home or abroad. If exchange rates are distorted and act to increase the effective cost of buying U.S. goods, we cannot expect to sell as much as we should be able to. If foreign nations are growing more slowly than the United States—and the differential is significant—U.S. imports will continue to increase at a faster pace than our exports.

Efforts to increase U.S. exports through active encouragement by the U.S. government and increased involvement by the U.S. business community in foreign markets must be complemented by general economic policies which will foster

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improved U.S. price stability, better U.S. productivity, realistic exchange rates, and increased growth overseas. We have been working hard in all of these areas, with success in some, but much more to do in others. The international community's reliance on more flexible exchange rates, concerted efforts to counter speculative distortions of rates when they are well out of line with underlying realities, and the narrowing of U.S. and foreign growth differentials should all help to create an environment which is more conducive to U.S. exports.

Inflation, however, remains our number one national problem and must be reduced.

We must also overcome our low rate of productivity growth. U.S. output per man hour in the manufacturing industries increased only slightly more than 25 percent between 1970 and 1976, while Japanese productivity grew by more than 50 percent, and German, French, and Italian productivity grew by more than 35 percent. Last year, American manufacturing productivity grew by an abysmal 0.8 percent. One of the most important factors behind this slow growth has been the virtual halt in capital accumulation since 1974. A stronger dollar should enhance the environment for portfolio investment. Our anti-inflation program will help restore after-tax real profits. And the recently enacted tax program should assist investment through a cut in the corporate rate, a reduction in capital gains taxation, and an improved investment tax credit. U.S. industry must also place greater emphasis on investment and new research and development to keep pace with changing market tastes and demands, particularly in those areas in which we can be most competitive both at home and abroad.

The U.S. Government has also taken a number of steps to spur export growth in particular. New measures which the President announced in September 1978 include:

- A proposed $500 million increase in the Eximbank's direct loan authority to a record $4.1 billion for FY 1980 to help improve the Bank's competitiveness and flexibility in terms of interest rates, length of loans, and percentage of transaction financed. This is in keeping with strong administration support for steady, sharp increases in the Bank's activities since FY 1977, when actual financing dropped to a recent low of $700 million.
- Loan guarantees of up to $100 million by the Small Business Administration to help small exporters.
- An additional $20 million for Commerce and State export development programs.
- Careful review by executive departments and independent regulatory agencies of the possible adverse effects on our exports of major administrative and regulatory actions, including the use of export controls for foreign policy purposes.

As the President noted in his export policy message, "Increasing U.S. exports is a major challenge—for business, for labor, and for government. Better export performance by the United States would spur growth in the economy. It would create jobs. It would strengthen the dollar and fight inflation.

"There are no short-term, easy solutions. But the actions I am announcing today reflect my Administration's determination to give the United States trade deficit the high-level, sustained attention it deserves. They are the first step in a long-term effort to strengthen this Nation's export position in world trade."

Actions since September 1978

To implement this new policy, a number of specific measures have been adopted since September:

- Eximbank has instituted useful new programs to encourage smaller exporters, agricultural commodity sales, and engineering and construction services. It has also undertaken major efforts to meet foreign competition by matching foreign terms for direct loans and other measures.
- Commerce has begun work on a computerized information system which will provide exporters with prompt access to international marketing opportunities abroad and will expose American products to foreign buyers.
- State plans to increase the number of commercial officers in the key Near East market.

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- A comprehensive interagency study of direct Federal export disincentives is underway, with a final report due in June.
- OMB has directed regulatory agencies to undertake a detailed analysis of how the U.S. foreign trade position would be affected by any significant regulations which they propose.
- The Commerce Department has developed new procedures to assure that export consequences are taken fully into account when considering export control regulations and to give weight to foreign availability in the administration of export controls for foreign policy purposes.
- Commerce and Justice are preparing written guidance for the business community on the scope and meaning of the Foreign Corrupt Practices Act to help reduce some of the uncertainty about the application of this statute.
- A Business Advisory Council has been created to advise the National Commission for the Review of Antitrust Laws and Procedures and has offered recommendations which have been adopted by the Commission in its report to the President.
- The Justice Department has instituted new procedures to reduce the time required for processing requests for guidance on export-related issues under its business review procedure.
- President Carter has issued an Executive Order which exempts export licenses from environmental reviews and reduces uncertainties about environmental requirements for other exports.

The Federal Government has also made decisions in a number of cases since September which reflect the administration's commitment to increase exports and to carefully weigh the impact on U.S. trade of potential controls on exports for foreign policy reasons. A number of these decisions involved both foreign policy and economic considerations of some importance, and might not have resulted in U.S. export sales under previous administration guidelines.

- The Commerce Department has authorized the export of $280 million of flatbed trucks and commercial aircraft to Libya on the basis of a determination that these would not be used for military purposes.
- Over $200 million in technical data and equipment for exploration and production of petroleum and natural gas in the Soviet Union have been authorized for export since the imposition of special controls in August 1978.
- The administration has decided to permit the sale of a $6.8 million American computer system to the Soviet Union's official press agency, Tass, to help in its handling of the 1980 Olympics. This decision was based on modifications in the original application and a decision that national security would not be compromised by the sale.
- Eximbank has also issued a letter of interest in financing $270 million worth of hydroturbines to Argentina.

In each of these cases the decisions have been difficult and have had to weigh a number of factors. National security, human rights, or environmental and safety considerations must be taken into account in final export control decisions. But it is evident from these recent cases that the administration is making a real effort to tilt toward exports when borderline cases might otherwise result in denial of export licenses.

The recent defeat of congressional amendments which would have denied the provision of export credits by Eximbank to certain countries for reasons of human rights seems to indicate that Congress is tilting in this direction as well, while maintaining our overall commitment to improve human rights in the most effective manner.

Benefits from the MTN

Our export strategy has been essentially twofold: (1) Preferably, to get others to cease or reduce government intervention in international trade or (2) to match their intervention or retaliate ourselves where necessary to assure U.S. export and import-competing industries alike a fair shake in international trade. We believe strongly in

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the free market system as the most efficient way to allocate scarce resources both at home and abroad. Further reducing international barriers to trade should benefit all nations. But we must also reduce and regulate the use of government subsidies which distort normal trade and investment patterns.

The recently concluded multilateral trade negotiations have provided a major step forward in reducing both traditional tariff barriers and regulating government intervention in such areas as subsidies, government procurement, and safeguards.

Under the new agreements, the United States will be a major beneficiary of tariff cuts averaging 30 percent or more on $100 billion of imports of manufactures by the other industrial nations. One agreement alone, that providing for duty-free treatment on trade in civil aircraft, will affect several billion dollars in U.S. exports. The United States also has obtained concessions covering more than $4 billion in annual U.S. agricultural exports. These figures will be augmented by industrial and agricultural trade agreements still being worked out with a number of developing countries.

As for the nontariff measure codes, that on government procurement alone will open up $20 billion in present procurement by foreign nations, compared to some $12 billion in U.S. procurement which will be opened to foreign bidding. The codes on customs valuation, licensing, and standards cannot be easily quantified, but restrictive practices in all three areas can have an even more distortive effect on trade than tariff barriers; we expect significant benefits to U.S. exporters from their adoption. Moreover, all the codes include provisions for publishing rules and procedures and for resolution of disputes, which will enable redress when they are the targets of discriminatory treatment.

We are especially pleased with the new subsidy/countervailing duty code, which addresses one of the most contentious issues in international trade in recent years: The increasing tendency for governments to intervene in both domestic and international markets to stimulate exports or increase domestic production in a manner that distorts the trade of other nations. The United States made the conclusion of such a code our number one priority in the multilateral trade negotiations, as an essential element of future trade cooperation.

The new code provides much stronger guidelines to regulate the use of subsidies and countervailing duties, improved enforcement against unfair subsidy practices, and much better dispute resolution procedures. The United States has been particularly encouraged by the decision of Brazil to formally join the new code and to agree to phase out its use of export subsidies in the years ahead. Other developing nations, including Mexico and India, have given strong indications that they will join as well.

These are major steps which should benefit U.S. exports. The benefits, however, cannot be realized overnight. Some of the new administration programs will take time to develop and implement. Commerce's new computer information system, for example, will not be in operation until at least 1980. Response of small businesses to new loans offered by the Small Business Administration has been slow. Other measures to reduce Government disincentives to exports are still under review. The new U.S. export policy necessarily looks toward the future, but can't promise results tomorrow.

Calls for even greater efforts

More may well be needed. The National Governors Association, representing the Governors of all of the American States, has called for further efforts to reduce delays in processing export license applications; decisions in export control cases which place greater emphasis on the effectiveness of U.S. controls in achieving policy objectives and on foreign availability; and advance notice for new export controls.

The Senate Subcommittee on International Finance has proposed the reorganization of the executive branch to support exports; revision of antitrust regulations to permit collaboration of industrial and agricultural firms for export (including trading companies on the Japanese and Korean models); further expansion of export promotion programs with greater attention to exports of services and to small businesses or firms new to exporting; tax incentives for research and development and exports; the tripling of Eximbank FY 1980 lending authority (to $12 billion), provision

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of mixed credits and joint financing, and Eximbank participation in trade with *all* countries; and further reduction of Government disincentives to exports.

The administration will give these suggestions full consideration in its continuing efforts to improve U.S. exports. More must be done by U.S. business, as well, to improve the business community's awareness of the importance of exports, to take advantage of export opportunities overseas, to produce specifically for the export market, and to concentrate production and research and development efforts in those areas in which the United States can be most competitive both at home and abroad.

Small- and medium-size businesses in particular need to become more involved in exporting. It's clear that most of our corporate resources now lie untapped and that the bulk of U.S. exports come from the largest U.S. corporations traditionally involved in international trade. While many have been suppliers to large exporting firms, smaller firms have found it much more difficult to keep abreast of foreign market opportunities or to meet the initial costs of entering foreign markets and establishing distribution networks.

A number of new Eximbank and Commerce programs will be tailored toward helping small- and medium-size businesses overcome present obstacles to exporting through improved information systems, special loans, and assistance to firms and industries with high export potential aimed at promising markets. We welcome further ideas from your membership on programs which would be helpful to assure that small- and medium-size businesses can make full use of their flexibility in adapting products to specific markets as part of our overall export effort.

Export credits

I would like to say a few words in closing about one final area where the U.S. Government has been playing an active role in seeking to reduce foreign government intervention in trade and to meet foreign competition in the use of official export credits. Here again, we are using the two-track strategy of getting other governments to limit their predatory intervention in official export credits, or, if that fails, matching these practices ourselves in some cases.

The competition in this area has been increasingly aggressive over the past year. It includes such practices as subsidized interest rates on official export credits and mixing aid packages with trade to make the credit terms more attractive. We tried to meet this competition through cooperation and negotiation as required by the amended Export-Import Bank Act. We had hoped international negotiations would resolve some of the issues posed by the predatory financing programs of other countries. We were less than wholly successful.

After an extensive series of discussions and meetings, the negotiations were terminated. The gap between what we were willing to accept and what the others, mainly the Europeans, were willing to offer was simply too broad.

As a result, we are using our own resources much more aggressively to meet the competition. I've already talked about one quantitative aspect of that new, more aggressive posture, the additional $500 million for Eximbank. Now let me talk about the qualitative aspects.

1. We are willing to offer long-term loans at interest rates not only well below commercial credit rates but even below Treasury's cost of money, to ensure—as much as we can—that U.S. exporters are not disadvantaged in competing with foreign producers supported by concessional export credits abroad.

Some cases in point include exports of a railway control system to Zambia, tractors to Mexico, and a thermal electric plant to Korea.

2. Foreign governments also offer aid mixed with trade, a practice we have termed "mixed credits." Where we have encountered this practice, we have attempted to persuade the foreign government to desist. In some cases, when the foreign government has refused to withdraw the mixed credit, we have matched the terms.

In Cyprus, for example, U.S. exporters of communications equipment were faced with unfair competition from the French. The French Government had mixed aid financing with trade financing, so that the overall interest rate of the package was lower than what our exporters could reasonably match. Eximbank stepped in with some assistance, and our exporters won the contract.

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3. Eximbank is also willing to cover more of the export value than it has in the past to provide long-term, fixed interest rate financing competitive with official credit offered by Europe and Japan. Aircraft exports are a case in point.

The European Airbus has been routinely supported by European official export credit agencies for up to 90 percent of the value of the plane. To match this financing posture, we have moved the Eximbank-supported portion of U.S. aircraft exports up to 90 percent in instances of head-to-head competition with Airbus. We did this recently in the case of Finnair, and the U.S. exporter won the contract.

4. We also are expanding the range of Eximbank services. Let me give you an example of what I mean. Several European nations offer official export credit support, particularly guarantees of private export credits, denominated in the currencies of other nations, especially the U.S. dollar. This practice allows the Europeans and Japanese more flexibility in meeting the demands of importers who may prefer one currency of repayment, say the dollar, to another currency, say the Japanese yen.

In those areas where the dollar has been used, it means that other nations have been able to use the dollar capital markets to finance their goods. The ability of the exporter to accept either currency in repayment means additional exports for his country, since the buyer can finance his purchases more easily in a currency of his choice.

Eximbank is now willing to offer a comparable service to U.S. exporters. While the Bank does not offer direct credits in a foreign currency, it will now guarantee loans denominated in foreign currencies. This should redress the advantages that other foreign export credit agencies have given their exporters.

It will allow an American exporter to tap foreign currency markets to finance his goods and have the Eximbank guarantee that transaction. This additional service by Eximbank will mean that importers of American goods may consider a wider range of financing sources in paying for that U.S. export, and that should mean an increase in the sales of American exports.

Another example of an expanded service that Eximbank offers concerns guarantees and insurance for construction and service projects in other countries. These guarantees will cover contractors against risks of confiscation, currency inconvertibility, war, or the failure of a government owner to settle disputes. It will greatly broaden the financial protection that we offer U.S. exporters of services.

Both the foreign currency and construction guarantee programs are indications of how we intend to meet competition from abroad in the field of export credits. They are tangible proof that we can play an equally aggressive export game against our competitors, especially if we have your help and support.

Exhibit 51.—Excerpts from remarks by Assistant Secretary Bergsten, May 11, 1979, before the Second Annual Conference on International Trade and Investment Policy of the National Journal, Washington, D.C., entitled "The Need for International Cooperation in the International Investment Area"

U.S. policy

U.S. policy with respect to international investment is based on the premise that the total benefits from international investment are maximized if governments seek to take no actions either to accelerate or hinder investment flows into or out of their national territories.

We believe that intervention into investment by home or host national governments may distort the efficient allocation of economic resources and thereby reduce the gains from international specialization of industrial output and the resulting gains from trade. Moreover, efforts by one government to tilt the benefits of international investment in its direction through interventionist policies are likely to prompt countermeasures by other governments, with additional adverse effects on world economic welfare and on overall international relationships. These effects are similar to those created by tariff and nontariff barriers to trade, export subsidies, and competitive depreciation of a currency.

Hence the U.S. policy toward international investment contains four important elements:

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1. The Government should neither promote nor discourage inward or outward investment flows or activities;
2. The Government should avoid measures which would give special incentives or disincentives to specific investment flows or activities;
3. The Government should avoid intervention in the activities of individual companies regarding their international investment; and
4. The Government views investment flows to developing countries to be a matter of particular concern.

The nature of the problem

This policy is tempered by the realities of today's world. It is clear that many governments actively intervene in the investment process in an effort to garner benefits for their national economies. Indeed, many State and local governments within the United States, and occasionally our own Federal Government, have made such efforts.

Such intervention takes many forms, but it can combine the use of investment incentives and performance requirements. Incentives are generally used to influence the locational decisions of individual firms. Performance requirements are imposed upon firms to ensure that they contribute to the priority economic and social goals of the host government. These usually focus on local job creation, transfer of technology to the local economy, and expansion of local value added and export levels.

These interventionist policies rest on an increasing commitment to growth of new capital formation, a commitment which the U.S. Government shares with other governments. Coordinated international action to spur new capital formation is a highly laudable objective, one which most countries are pursuing.

What is troublesome, however, are some of the ways in which governments are carrying out this objective. Rather than adopting generalized approaches which will increase total capital formation, governments often adopt industry-specific, or even firm-specific, measures which may only serve to redistribute existing investment or divert to a different location investment that would have been made in any event.

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If these measures continue to proliferate, conflicts between governments may develop. This would especially be the case if the world economy were to go into severe recession, and nations were to use investment incentives and performance requirements as a means to try to transfer the resulting unemployment in their economies to other nations. Under a floating exchange rate regime, the resulting inflows might cause the offending nation's currency to appreciate and thus to reduce its attractiveness as a place to invest. At its worst, a spiral of beggar-thy-neighbor competition might develop, where intervention by one government could stimulate emulative countermeasures by others to the detriment of all. We believe that no crisis of this nature will develop if we can develop a broad consensus on an international economic system permitting investment to flow across national boundaries according to economic forces.

A major objective of U.S. policy, therefore, is to achieve increased multilateral discipline on incentives and other interventions, both to maintain an open investment environment and to avoid emulative countermeasures. The 1976 OECD Declaration of International Investment and Multinational Enterprises and related decisions deal with aspects of the problem and represent an initial multilateral effort at strengthening multilateral discipline and increasing international cooperation on investment issues. Bilateral investment treaties and treaties of friendship, commerce, and navigation deal with some aspects of the investment relationship. None of these, however, constitutes more than a start at achieving international cooperation in this area. International trade and monetary affairs, by contrast, are governed by longstanding rules and institutional arrangements embodied in the GATT, in bilateral treaties, and in the Articles of Agreement of the International Monetary Fund. Major improvements in the trading rules have just been accomplished in the multilateral trade negotiations. We believe that similar cooperation on international investment should remain a priority item on the international economic agenda.

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The development of a basis for multilateral cooperation with respect to international investment has thus become an important part of U.S. international economic policy. We face a basic problem, however, in trying to achieve cooperation in that most governments have not yet recognized the need for increased international cooperation to maintain open principles regarding international investment. In part, this is because direct investment has become a major vehicle for international economic exchange only in the last 20 years or so, and its impact upon the international economy has thus not been visible for as long a time as the impact of trade flows and exchange rate changes.

A similar ambivalence exists within the United States. Many of our own laws, regulations, and policies affecting international investment and multinational firms have been carried out unilaterally, without full consideration of their international dimensions. Our own States and localities often extend incentives which attract investors from abroad as well as domestic investors. I have recently discussed this issue in meetings with representatives of State and local governments, under the auspices of the Advisory Commission of Intergovernmental Relations. The Commission is now studying the interaction between such internal U.S. actions and the international investment process, as part of its broader analysis of relations among the States themselves regarding investment policies. Similar subnational issues regarding international investment policy also arise in other countries with federal government systems, such as Canada.

Unaddressed, the underlying problems resulting from governments' use of incentives and performance requirements will likely get worse simply by virtue of the growing volume of international investment. The large firms of Japan and Europe increasingly are extending their investment activities into foreign lands along with their U.S. rivals. Some of the more advanced developing countries (e.g., Brazil, Mexico, Taiwan, Korea) have become hosts to foreign investment on a large scale. In addition, some large firms based in these rapidly industrializing nations have themselves become multinational, and hence several of these nations are now home as well as host to foreign direct investment. And growing investments by Germany and Japan in the United States promise to accentuate our own position as the second largest *host* to foreign investment, after Canada.

If past experience concerning the international interplay of national economic policies has taught us anything, it should be that we need to identify and devise means to address problems at an early stage—before vested interests become so strong that a crisis is required to bring forth appropriate international action. Failure to take early action in the area of trade, for example, led to trade wars and competitive exchange rate devaluations during the 1930's, actions which doubtlessly deepened and prolonged the Great Depression. Only after the Depression actually occurred were trade and monetary rules created that were designed to prevent its recurrence.

In the case of international investment, we are not yet to a point where vital interests have been sufficiently damaged as a result of undesirable national competition for international investment as to create a global crisis. Even so, individual problems, such as those mentioned above, have produced some clashes.

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The shape of international cooperation

To predict the form that international cooperation in the investment area might ultimately take is difficult. No matter what forum deals with this matter, several intellectual and institutional problems would inevitably have to be faced. For example, we might ask:

- When is an incentive legitimate as a means to offset the disadvantage of investing in a particular locale, and when does it exceed that bound?
- When does an incentive actually induce a firm to shift production from one nation to another, as opposed to influencing where among several sites within a nation it might locate?
- Can the investment issue be handled through the GATT and other instruments and institutions of trade policy, or does it call for separate or additional responses?

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We do not pretend to have clear answers to these questions. Nonetheless, we believe that it is important to try to distinguish an acceptable incentive from an unacceptable one. Two principles can be tentatively put forth: An undesirable investment incentive would be one which would *both* (1) cause industrial investment to be located in the territory of the nation granting the incentive, while in the absence of the incentive the investment would go to some other nation's territory, and (2) distort the efficient allocation of resources as between any pair of nations.

It should be noted that, under these principles, measures which are sometimes referred to as "incentives" but in fact amount to the removal of government-imposed disincentives to investment would not be condemned. Such exempt measures, for example, would include broad-based tax reductions and the liberalization of government regulations which affect business. These measures would constitute a move by government toward a "neutral" role in investment decisions. If one government moves toward "neutrality," it should be above criticism by other governments. By contrast, direct or indirect subsidies to a firm which are not compensatory in nature—including operating subsidies, subsidized loans, free provision or payment of front-end cash or noncash grants to the firm—would be covered.

We also believe that all incentives should be transparent and open to any potential investor. Thus, "tailormade" incentives which are offered only to a single, specific investor or group of investors should be avoided, even if the incentives are not in violation of the principles just stated.

Two categories of incentives may require special treatment. One encompasses incentives designed to draw investment into disadvantaged or depressed regions of a nation. The other covers incentives to research and development. Arguments based on sound economic reasoning suggest that a limited case might be made for direct subsidies in each of these areas. While I will not review the arguments today, special treatment for depressed regions and for research and development may be necessary.

Dealing with performance requirements is as difficult as dealing with investment incentives. In general terms, it can be argued on economic grounds that any performance requirement is undesirable unless it acts to offset some imperfection in the working of the market.

The problem is to determine what, if any, imperfections exist in a given situation and to determine if performance requirements act solely to correct the deficiency. Such a determination is particularly thorny in the context of the so-called North-South dialog. Performance requirements are often justified as necessary to assure that multinational enterprises meet local goals of host governments. But abuses by multinational firms in developing nations, while they undoubtedly occur, are much exaggerated, and we believe that the case for performance requirements is overstated. It is true that performance requirements are primarily designed to further the social goals of developing nations, however, and we must therefore be willing to be flexible in dealing with them on these issues.

Whether or not we should seek to deal with these issues in the context of the existing institutional framework for trade, or in another new context, is an intriguing matter. The recent multilateral trade negotiations (MTN) succeeded in establishing new international rules on government practices which affect the investment area. For example, agreement was reached on new international commitments to prevent or limit the effects on trade of export and domestic subsidy programs. Under the new MTN Subsidies/Countervailing Measures Code, a signatory could take countermeasures if it determined that another nation's subsidy program had caused material injury to one of the signatory's industries because of subsidized exports. In addition, in the case of an outright export subsidy, any adverse effect on another nation's trading interests would be sufficient to justify countermeasures. Some of the incentives currently used to attract foreign investment would be covered under these provisions. Under the new agreement, those countries whose production and trade interests are harmed by others' subsidies, including investment incentives, will have recourse to an internationally sanctioned means of dealing with the situation.

One might well ask why the entire problem of investment incentives cannot be handled through these agreements rather than through arrangements related directly to investment policies. Part of the problem in doing so lies in the fact that such

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incentives, rather than creating trade, may destroy opportunities for trade by creating import substituting investment and thus be hard to reach via trade mechanisms.

More importantly, however, use of tools designed to deal with actual trade flows would frequently represent a case of "too little and too late" in responding to investment incentives. In 1973, for example, the United States could respond actively to Canadian investment incentives which lured a Michelin tire plant to Canadian soil only after imports of tires from the plant began to enter the United States. Action was needed before the plant was built. Trade sanctions, such as countervailing duties, have traditionally been taken after production is underway and trade is established, long after millions of dollars are invested in a facility and jobs are transferred from one location to another. When that kind of damage has already been done, trade sanctions have been unable to remedy the injury. It is possible that the threat of a countervailing action by another country would have some deterrent effect on government subsidies, and we are now studying how much of the investment incentive problem can be met by the new GATT rules. But whatever the agreed mechanism, the important thing is to deal with competition between governments at all levels.

Conclusion

As I have indicated, the groundwork for further international cooperation is now being laid. At this point in the discussions, the outcome is uncertain.

Those of us who are convinced of the need for additional international action to deal with the problems arising from governmental intervention in the investment process face a difficult period of education and persuasion to overcome the skepticism of those who as yet remain unconvinced. We must also solve the tricky substantive questions involved in establishing criteria as to which incentives are acceptable and which are not. We will proceed, however, with the mistakes of the past fully in mind and in the conviction that these difficulties can and will be overcome.

Exhibit 52.—Excerpt from remarks by Secretary Blumenthal, May 17, 1979, at the National Council for U.S.-China Trade, Washington, D.C., regarding a change in U.S. economic relations with China

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It is a great pleasure to address this esteemed group on the occasion of its sixth annual membership meeting. I remember vividly the early discussions leading to the establishment of the Council in which I played an active part. You have come a long way since those days. And no year has been as momentous as this past one. For this past year has seen a sea-change in our economic relations with China.

On December 15 of last year the President made his historic announcement concerning normalization of diplomatic relations with the People's Republic. At the dawn of the new year Deng Xiaoping visited Washington and issued with President Carter a communique setting out, among other priorities, an intention to negotiate trade, shipping, and aviation agreements and to get on with the business of bilateral commerce. In late February a Treasury delegation traveled to Beijing where we began to lay a foundation. We opened our Embassy and negotiated and initialed a claims/asset settlement. We initiated discussions on trade. And we established the U.S.-China Joint Economic Committee to oversee and coordinate the expansion of our bilateral economic relationship.

Now, in this past week, Secretary Kreps has signed the claims/assets accord and has initialed a most-favored-nation trade agreement. She has negotiated four science and technology agreements and an accord on trade exhibitions. And negotiations on textiles, maritime and civil aviation agreements are in the works.

In less than 6 months we have gone from zero to full speed ahead in our bilateral economic relations with China.

We have substantially bridged the gap that has separated the United States and the People's Republic of China for two decades.

So, where does this leave us? Specifically, what are the prospects for American firms who wish to do business with and in China?

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To answer that question requires that we assess: (a) the current domestic situation in China; (b) the status of the competition; (c) the political and economic wherewithal of the private and public sectors at home. Let me review these for you in turn.

The situation in China

The speed with which the obstacles to a more normal bilateral economic relationship are being overcome pales when compared to the pace of change that has occurred domestically in China. In the past year the new Chinese leadership has attempted some remarkable transformations.

On the economic side, the Four Modernizations has become the national goal. The people have been exhorted to "act in accordance with economic laws"; to stress practical economic considerations. New party organizers and nonparty intellectuals and technicians have been brought in to implement the new economic plan. And government bureaucrats, students, and workers are being given a vested interest in economic progress.

The National People's Congress early last year approved a highly ambitious 10-year plan. In agriculture, the plan calls for increased investment, increased incentives, and a decentralization of the decisionmaking process. In industry, the intent is to modernize the nation's industrial plants through the acquisition of Western machines and technology for production of petrochemicals, synthetic fibers, metals, transportation, and communication. The leadership has also relaxed constraints which had previously inhibited the application of foreign methods. Most striking amongst these relaxations has been the decision to consider a variety of investment schemes. When I was in Beijing, the Government made it clear that they were fully open to alternatives such as joint ventures, barter and product payback deals, long-term credits, and government-to-government loans to finance modernization.

There has of late been some "readjustment" of these efforts. There has been debate on economic priorities: Some of the more ambitious goals have been scaled down and there has been a partial reemphasis on agriculture and light industry. Still the Chinese tell us, and we believe them, that they are "firm and unshakable" in their drive to modernize. Indeed, the Foreign Trade Minister, Li Qiang, summarized the situation recently by saying that "the readjustment of our economy undertaken at the moment is exactly for the purpose of concentrating our efforts on the most needed projects and widening the pace for the Four Modernizations."

It is not really surprising that this kind of readjustment takes place. The Chinese stated frankly from the outset that their plans were ambitious and we, for our part, warned our business interests against unrealistic expectations. Still, in a manner akin to those who watch and read so much into the weekly changes in the money supply, the new China watchers have begun to read something fundamental into every new piece of evidence emanating from China, be it the sales figure for the Canton Fair or this or that poster on Democracy Wall. The point I suppose we all agree on is this: China is embarked on a rapid path of change. Adjustments and threats to endurance are inevitable. As with most such efforts, the potential return is great. But so equally is the risk.

Mr. Ambassador, I know you won't mind my saying that there are risks in any attempt of change. We know this well from our own attempts to change the inflation psychology of our own economy. No one can assess the risks entailed in so fundamental and unorthodox an attempt as that being made by Vice-Premier Deng and Chairman Hua. Investors must make up their own minds as to whether or not a process of development like this one, once underway, can be stopped; or whether a political effort of this basic nature, once embarked on, can ever be reversed; or whether the people will have the patience to stay the course and accept the strains and setbacks that are inevitable.

The domestic situation in China tells us that we must approach investing and doing business there with a sense of realism and proportion. Obviously, profitable business can be done in China and we are eager for it. But for some time to come business will have to be done under conditions of uncertainty. This is a fact.

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The competition

This does not mean that there is lack of room for an expansion of America's market share in China. Others have done quite well in the current trading environment and have strong expectations for the future. Let me describe briefly where we stand relative to the competition.

The United States ranks well behind Japan and Europe in trade with China. In 1978 China imported a little over $10 billion of goods from abroad; the United States supplied only 8 percent of this total. In that year China exported goods totaling almost $10 billion, of which the United States imported 3 percent. Our total share of two-way trade with China is a slim 6 percent. This compares with 25 percent for Japan and 18 percent for the European Community. We can and we must do better.

In seeking to expand our position, we must contend with the following competitive situation:

- We must compete against Japan. In 1978, Japan captured, by value, half of the $7 billion worth of contracts signed by the Chinese. The Japanese and Chinese have signed a long-term trade agreement which has been extended through 1990 and aims to increase two-way trade to $40–60 billion. In addition, the Japanese government and private banks have been discussing a variety of long- and short-term facilities to finance this trade. Just yesterday, for example, Japanese private banks signed a 4½-year syndicated loan to China of $2 billion denominated in dollars. And they announced short-term loans totaling $6 billion.
- We must compete with West Germany, who does not have a bilateral trade agreement, but already sells $1 billion in exports to China.
- We face competition from France and the United Kingdom, who each recently entered into trade agreements with China which call for bilateral trade to approach the $14 billion mark by 1985. To finance purchases under the agreement, both France and the United Kingdom have officially backed $7 billion and $5 billion, respectively, in credit commitments.
- And there are others. The European Community collectively signed a 5-year nonpreferential trade agreement with China in April of 1978. And Italy has been discussing a trade agreement with China and is reportedly considering extension of an officially backed line of credit for $1 billion.

It is possible that the expectations of all of these governments are exaggerated. Still, the bottom line is that we are behind in our economic and trade relations with China. We must move quickly to get ahead. The businessmen in this room know how hard it is to do so—how hard it is to compete against others with sizable leads in market share. Nevertheless, I am confident that we can substantially increase our share of the Chinese market.

Business and Government effort

In part this confidence is bred of what I have experienced firsthand: The Chinese understand the superiority of American technology and managerial skills. There is no doubt that China intends to tap into our strengths in these areas. This was made clear to me on my recent trip. The Chinese like American businessmen. They trust them. They are fully knowledgeable of the abilities of our oil companies, our mining firms, our builders, our manufacturers, our consultants.

Secondly, as I hope I made clear in my introduction, the Carter administration is doing its utmost to encourage business with China. We have settled the claims issue so that Chinese deposits, ships, planes, and goods can enter the United States without fear of attachment. We have initialed a trade agreement which provides for patent protection, for the facilitation of business, and, importantly, for the eventual extension of most-favored-nation status to China. We have set up a Joint Ministerial Committee to facilitate the clearing away of remaining obstacles.

There can be no question of the administration's resolve to enhance the business community's involvement in China. Nor, judging from the wave of American businessmen visiting China and the mushrooming of "doing-business-in-China workshops," can one doubt the business community's interest in this new market.

Still, there are significant obstacles which we must overcome.

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The first is principally a matter between private U.S. firms and the Chinese Government. In his meeting with Mrs. Kreps, Deng Xiaoping joked that one of the great problems we have in fostering bilateral trade is that China has too few laws and the United States too many lawyers. Actually this is no small matter. The Chinese are genuinely perplexed about our preoccupation with the law. To satisfy U.S. investors, and other investors as well, they must finalize a commercial code. Acceptable groundrules must be laid down on taxation, on protection from expropriation, on profit remittances, on dispute settlements, and on myriad other concerns common to joint ventures and the other new forms of investment being contemplated by Beijing. Alternatively, the American business community might have to learn to take risks which the absence of traditional guarantees present, much as the Japanese and others have done. It will no doubt take time before the new operating procedures required of the Chinese Government and the American private sector are worked out to everyone's comfort.

A second problem relates to the extension of Export-Import Bank credits to China. As most of you know, Eximbank lending is covered by the restriction of the Jackson-Vanik amendment. And under the Export-Import Bank Act, the Bank cannot extend credits to Communist countries without a Presidential determination that it is in the national interest to do so.

We believe that we can get over these legal hurdles. But even as we do so, we will confront two problems. The first is that the People's Republic of China has a $26.5 million debt (principal amount) to the Eximbank that must be repaid. As Ambassador Chai knows, I briefly outlined our position on this matter to his government while I was in Beijing: Until this official claim is negotiated, it is unlikely that the Export-Import Bank will be able to justify the extension of any new loans.

Second, the Bank's budget for FY 1979 is substantially allocated. Without an addition to the Eximbank budget, it is unlikely that credits can be extended before October of this year.

The point is that we can't look to the U.S. Government to provide a great deal of financial resources this year. I know that this is a sensitive issue and the cause for complaint, but those are the facts, despite the nature of the competition and despite the new willingness of China to take in our business.

This does not mean that credit is unavailable. The Chinese have begun to tap the international market.

- A 5-year, $750 million untied Eurodollar loan is being negotiated with a syndicate headed by a Canadian bank.
- Another 5-year, $175 million general purpose loan has recently been arranged for China by two European banks.
- Chase Manhattan recently announced a $30 million loan to finance the initial stage of a $250 million trade center in Beijing.
- And just recently, China has obtained a commitment for a $500 million loan from an Arab consortium.

Concomitantly, U.S. banking activity in China has picked up dramatically. Fourteen U.S. banks now have established full correspondent relations with the Bank of China. And three have been given permission to set up representative offices. Given China's preference for dollar-denominated loans, I expect these and other U.S. banks will expand their banking operations in China.

In short, private sector resources are growing, if not yet plentiful. We acknowledge that a lack of Ex-Im financing will place us at a disadvantage for the immediate future—for 1979. But that disadvantage should hopefully be minimized by private credits.

Conclusion

In conclusion, let me summarize the situation as I see it. To succeed in the Four Modernizations, China must attract investment. To succeed in attracting American investment, business must be assured of a stable environment, government efficiency, and working commercial codes of conduct. To facilitate that investment, the U.S. and Chinese Governments together must continue to move expeditiously toward final ratification of the trade agreements, completion of the textile, aviation, and shipping

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agreements, and a resolution of the Eximbank issue. But that will not be enough. American banks and American businesses must be willing to invest a great deal of time and incur a substantial amount of risk in order to enter China and gain market share. The process will be an arduous one. But the rewards will undoubtedly be great.

Exhibit 53.—Excerpt from remarks by Assistant Secretary Bergsten, June 19, 1979, before the Financial Times Conference on World Wide Investment in the United States, New York, N.Y., regarding foreign direct investment in the United States

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U.S. policy

Thus the foreign direct investment issue was not a contentious one when this administration took office 2½ years ago. We recognized, however, the importance of foreign investment, both inward and outward, to the U.S. economy and to overall U.S. international economic relations. Hence we undertook a fundamental review of U.S. policy in this area. The result of this review was a statement, issued in July 1977, confirming the longstanding U.S. commitment to an open international economic system.

Specifically, the statement said: "The fundamental policy of the U.S. Government toward international investment is to neither promote nor discourage inward or outward investment flows or activities." Therefore, the Government "should normally avoid measures which would give special incentives or disincentives to investment flows or activities and should not normally intervene in the activities of individual companies regarding international investment. Whenever such measures are under consideration, the burden of proof is on those advocating intervention to demonstrate that it would be beneficial to the national interest."

This policy is based on a careful and pragmatic assessment of the national self-interest, though it comports as well with our philosophical preference for open markets and a minimum degree of government interference. Investment in this country which originates from abroad is no less beneficial to our economy than investment which originates here. We need more investment in the United States because we need more jobs, more exports, more productive capacity to fight inflation, and new technologies. In the interdependent world of today, it is apparent that enterprises based abroad have much to offer to help us meet these goals, just as U.S.-based enterprises have helped other countries throughout the postwar period to meet their economic goals. Thus, to discriminate against—or in favor of—investors simply on the basis of their nationality would have no economic rationale.

In sum, our posture toward inward investment is quite positive—we have an open door and the welcome mat is out. Furthermore, we intend to assure that the door stays open, by resisting proposals to establish any new restrictions on foreign investment unless it can be clearly demonstrated that such restrictions are necessary to protect the national interest.

The United States, like all countries, does limit or prohibit foreign direct investment in specific sectors. Examples include aviation, coastal shipping, atomic energy, radio and television broadcasting, and mineral development on Federal lands. Several of these restrictions date back to the 1920's or 1930's. None are of recent vintage. For the most part, these restrictions were established on an ad hoc basis, so there is little uniformity in them and they are not an accurate reflection of U.S. policy toward foreign investment.

Recent developments

Investment from abroad has become of increasing importance to the U.S. economy in recent years. Until the early 1970's, the United States was perceived almost entirely as a home country for investment abroad. Now we are becoming significant as a host country to foreign investment, and are second only to Canada in this respect.

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In the 5 years 1973–78, the stock of foreign direct investment almost doubled—from somewhat over $20 billion to nearly $40 billion. Last year, the increase of $5.6 billion was a record and increased the total stock by over 16 percent.

While these figures testify to the strong interest of foreign investors in the U.S. economy, they do not constitute a "flood" of foreign investment as is sometimes reported by the press. While a near-doubling in 5 years is impressive, the GNP itself increased by 61 percent over the same period, and the fact that foreign investment here prior to the early 1970's was increasing at a rate below the GNP rate of increase suggests that some "catching up" by foreign investors was natural, even overdue. Even the record 16-percent increase in 1978 is not much greater than the GNP increase of nearly 12 percent, and the 1974 increase was actually greater than the 1978 increase in deflated dollars.

There are two specific areas in which foreign investment has been particularly controversial lately. One is banking. Within the past year, there have been a number of actual or proposed takeovers of U.S. banks by foreign interests. This has raised concerns within this country about foreign influence over the U.S. banking system and the adequacy of our laws and regulatory capabilities in this area.

We have been examining this issue since intended foreign acquisitions of U.S. banks became significant over a year ago. The safety and soundness of the U.S. banks, reciprocal treatment of U.S. banks abroad, and our general national interest in the free flow of investment capital are some of the considerations involved. We will continue to examine the issue, but thus far there is no indication that recent or prospective acquisitions are a threat to the national interest—and hence to our policy of openness toward foreign direct investment.

There has also been some concern about reports of large-scale purchases of U.S. farmland by foreign interests. All our data indicate, however, that foreign purchases of U.S. farmland have not been substantial by any standard. A recent report to a Senate committee by the Department of Agriculture estimated, in fact, that at the rate at which foreigners are investing in U.S. farmland it would take them 19 years to acquire an additional 1 percent of the total.

We are currently in the process of improving our data in this area. Pursuant to a law passed last year, the Agriculture Department is establishing a nationwide system to monitor foreign purchases of U.S. farmland. It also has underway a study to determine the best long-range approach to monitoring foreign investment in U.S. real estate. In the meantime, however, we have concluded that in the case of farmland there is no basis for departing from our basic policy of not discouraging foreign investment.

The future outlook

My remarks thus far have been addressed to the past and the present. What about the future? What will U.S. policy be in 5 or 10 years? Will the open-door policy continue indefinitely? What if the inflow of foreign investment should grow to such proportions that it were perceived as a threat to the national interest?

Obviously I cannot give assurances on U.S. policy in the distant future. But the principles which are the basis of past and current policy are likely to hold for the indefinite future, because they are firmly rooted in our national self-interest. Indeed, these principles may well become even more deeply rooted because the world will become even more interdependent than it is today, and any notion of discriminating against investors simply on the basis of their nationality or place of residence will have even less rationale than it has today.

While we cannot guarantee that logic will always be the dominant factor in determining economic policy, we do have in place a procedure in the U.S. Government which serves as something of a safeguard against actions contrary to sound long-term considerations. The Committee on Foreign Investment in the United States, an interagency committee which I chair, was established by Presidential Executive order in 1975 to monitor the impact of foreign investment in the United States and to coordinate U.S. policy in this area. It is also charged with reviewing any specific investments which might have major implications for the national interest and to make recommendations in this regard, if the need arises, to Cabinet-level bodies.

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This procedure was established in response to congressional concerns about the possible implications for the national interest of foreign investment in this country, particularly by the governments of the OPEC countries. But it also serves as a safeguard against precipitous action against foreign investors. As I noted earlier, our policy statement puts the burden of proof on those advocating intervention "to demonstrate that it would be beneficial to the national interest." In the case of a specific investment being reviewed by the Committee, the guidelines state:

> The basic presumption for any review is that the proposed investment does not have major adverse implications for the national interest and the burden is on any member who thinks otherwise to so demonstrate. In the absence of such a demonstration, the conclusion of the review is that the Committee has no objection to the investment.

This burden-of-proof safeguard, along with the traditional American resistance to Government intervention in the private marketplace and the hard fact of international economic interdependency, bodes well for the future of an open-door U.S. policy toward foreign direct investment.

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Commodities and Natural Resources

Exhibit 54.—Statement by Deputy Assistant Secretary Junz, October 2, 1978, before the European-American Commodities Conference, London, England, entitled "Intervention in World Commodity Markets: Appropriate or Not?"

The pricing of raw materials has been a policy concern for many years. Abrupt changes in demand, cyclical shifts in business activity, and exogenous factors affecting supply, such as weather conditions or natural disasters, can lead to large price swings. These, in turn, can have adverse effects on consumers and producers alike.

Traditionally, the problem of instability in commodity markets has been left to producers to resolve. However, during the past couple of decades, the mutuality of concerns of consuming and producing nations has come into sharper focus, with the increasing recognition that boom-bust commodity cycles are detrimental to both. They fuel inflationary tendencies in the consuming countries, and to the extent that these price pressures become embedded in wage structures, they are in turn transmitted to the producing countries via import prices. For developing countries heavily dependent on the production and export of commodities, excessive price volatility can severely frustrate long-term development planning and create distortions in development patterns through large shifts in domestic savings, tax revenues, and foreign exchange earnings, leading to alternating surges in inflation and periods of recession and unemployment. Thus, both sides have recognized the desirability of finding ways and means to bring about greater stability of commodity prices.

In recent years, however, the concern for greater price stability has given way to a much broader range of issues. On the side of the developing countries (LDC's), the main underlying goal has been to obtain a sufficient and stable flow of financial resources to meet domestic economic and political objectives. This, and a rising determination in the developing countries to right the injustices of a colonial past, have sharpened their desire to obtain transfers of resources as a matter of right rather than at the discretion of donors. Thus, the LDC's have sought ways to increase their access to additional resources on an automatic and unconditional basis.

These efforts intensified following the supply shortages of 1973–74 and the success of the cartel action of the Organization of Petroleum Exporting Countries (OPEC). As a consequence, political demands recently have concentrated on changes in international economic arrangements that would give developing countries a greater voice in decisionmaking, provide greater access to international financial resources on an unconditional basis, and establish price-strengthening commodity agreements (ICA's) to assist in increasing export earnings.

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In pursuing these aims, the LDC caucus, known as the Group of 77 (G–77), has established a surprising degree of political cohesion which has enabled the LDC's to formulate and maintain joint positions throughout a full schedule of international conferences. Consequently, considerable momentum was generated for positive consideration of a number of their demands. But, actual translation of these demands into action has been complicated because maintenance of political cohesion has also meant inflexibility in negotiations. This inflexibility derives from the fact that any negotiation must seek to accommodate the interests of each and every grouping among the LDC's.

The producer initiative

The momentum created by the joining together of the LDC's led to the adoption by the international community of the Integrated Program for Commodities (IP), initiated by the developing countries, at UNCTAD IV in 1976. But the IP also demonstrates the need to include their whole range of interests. The objectives of the IP included:

- Reduction of excessive price fluctuations in raw materials of production and export interest to LDC's;[1]
- Expansion of processing of primary commodities and diversification of productive capacity in LDC's;
- Improved access to developed-country markets for processed forms of raw materials;
- Improved and sustained real income for developing countries through increased and stabilized export earnings; and
- Improved competitiveness of natural products vis-a-vis synthetics.

The developing countries felt that these objectives should be achieved by considerable and far-reaching intervention in and regulation of commodity markets. The mechanisms proposed included buffer stock arrangements for at least 10 core commodities, and development-type measures for all 18 commodities in the IP.

The LDC's envisaged that talks between producer and consumer countries would result in agreement on specific measures for each of the 18 commodities. The range of possible measures would include (1) price-stabilizing mechanisms such as international buffer stocks and national stocks, (2) price-raising devices such as production controls and price indexation, and (3) a variety of developmental measures including product diversification, market promotion, R. & D., and processing.

The producers proposal for a natural rubber agreement, for example, contains all three types of measures. Producers have pressed for a 300,000- to 400,000-metric-ton buffer stock to stabilize prices, an export and production control system, a price revision mechanism based on changes in production costs and the prices of synthetics, and a large, consumer-financed fund for a wide range of non-buffer-stock measures.

The principal integrating element, pulling together the diverse objectives and measures under the IP, has been a common fund (CF) that would finance the entire range of commodity measures. Financing for the CF would come from several sources: First, from producing and consuming countries participating in ICA's; second, from contributions from members of the CF at large, with the major share coming from the developed countries; and third, from loans raised on private capital markets. Funding was initially put at $6 billion. The CF would lend ICA's the necessary resources to acquire physical stocks in the market, with repayment required when the stock is sold. Financing of non-buffer-stock measures would include a significant grant element. In the management of the CF the developing countries would have "decisive" control on the basis of the one-country-one-vote principle.

U.S. policy response

The basic approach of the United States to the IP has been to look positively but discriminatingly at those mechanisms that can provide substantial benefits to both consumers and producers of primary commodities. In doing so, we have, as have many

[1]The commodities include a core of 10—cocoa, coffee, copper, cotton, hard fibers, jute, natural rubber, sugar, tea, and tin—for which buffer stocking were claimed feasible. Eight others, for which other types of international measures were called for, included bananas, bauxite, iron ore, manganese, meat, phosphates, tropical timber, and vegetable oils.

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other industrialized countries, supported measures designed to achieve greater price stability. To promote the increase of productive capacity and other measures appropriate to development policy, we have supported action through those mechanisms designed to transfer resources for such purposes. We have rejected measures that would transfer resources through price-raising mechanisms, because these would act to destabilize demand and supply over the longer term and disrupt markets to the detriment of both producers and consumers.

Commodity Agreements

U.S. participation in ICA's is conditional upon certain basic principles. ICA's—

Must be designed to stabilize prices around underlying market trends, *not* to raise prices above those trends;

Must balance the interests of producers and consumers, in terms of responsibilities and benefits; and

Must provide wide latitude for the operation of market forces.

We have concluded that these principles are best served by buffer stock arrangements. Under a pure buffer stock regime, the benefits of price stabilization to producers and consumers balance out over the longer term. Buffer stock arrangements help to maintain prices during periods of excess supply to the benefit of producers, and lower prices during periods of shortages to the benefit of consumers. By reducing commercial risk, increases in investment, production, and consumption take place at lower costs, to the benefit of *all* market participants. Such commodity agreements complement, rather than impede, the operation of market forces.

Commodity agreements that rely on production and/or export controls impede the operation of market forces, create market inefficiencies, and eventually lead to a misallocation of resources. Production controls force low-cost and high-cost producers to cut back output equally, thereby locking industry into inefficient patterns of production. In addition, agreements that rely on supply controls tend to freeze existing market patterns as they bar entry of new, and possibly more efficient, producers.

The free play of the pricing mechanism is essential for efficient buffer stock operations. Market prices trigger stock purchases and sales in the short run and allocate resources efficiently in the long run. For this reason, buffer stock arrangements should provide for price ranges that are easily adjustable to market trends and are sufficiently wide to allow prices to play their allocative role.

The U.S. proposal for a natural rubber agreement provides a clear statement of how the basic objective of price stabilization can be met without disrupting market operations or restricting supply. Our analysis indicates that a buffer stock of around 700,000 metric tons, some 20 percent of annual consumption, would be adequate to stabilize prices within a ±20-percent range around their medium-term trend. With an adequately sized buffer stock and appropriate arrangements for adjusting price ranges when necessary, no backup supply mechanisms should be needed.

Although we generally oppose supply controls as a price-stabilizing mechanism, there may be a case for export quota/national stocking schemes for commodities which are unsuitable for an internationally held buffer stock. This applies particularly to commodities for which storage costs in a central location are high, which may have a very high supply variability or where other technical factors make pure buffer stock arrangements uneconomic. However, under such circumstances, frequent reallocation of quotas should assure continuing responsiveness to changes in supply capabilities. Such reallocation allows for easy entry of new producers and for the shifting of market shares from inefficient to efficient producers. Furthermore, coupling quota arrangements with national stocking schemes assures that productive capacity is not artificially limited and helps ensure that supplies will be available to protect consumers in the event of price surges. Examples of export quota/national stocking arrangements are the recently negotiated coffee and sugar agreements.

For a number of other commodities such as bananas and tea, a viable stocking scheme is simply not feasible. Moreover, for these and a number of other commodities listed in the Integrated Program, price volatility is not the basic problem. Where commodities are faced with competition from substitutes and longer run declining demand—like jute and hard fibers—development of new end-uses, promotion of consumption, productivity improvement, and related measures provide the best

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solutions. By contrast, price stabilization schemes can do nothing to remedy such situations and price-raising arrangements, such as proposed by some producers, would only worsen them.

The Common Fund

Commodity agreements of the type we seek must be adequately financed to enable them to build buffer stocks of sufficient magnitude to stabilize prices effectively. We believe that by consolidating the assets of individual ICA's in an appropriately structured CF, actual budgetary drains on participating member countries could be reduced significantly. Furthermore, implicit in our proposal for a CF is a contingent commitment to share in the financing of buffer stock arrangements, thereby reducing the financial burden on producers.

According to our proposal, ICA's would deposit a predetermined portion of their maximum financial requirement (MFR) in the CF and thereby be entitled to a credit line for the balance of their MFR. The credits would be backed by negotiable warehouse receipts (stock warrants) of each ICA as stock is acquired and by capital on call from ICA member countries. The presumption is that, barring exceptional circumstances, capital would not have to be called. Under normal circumstances, the CF would lend from unused deposits from ICA's in a selling phase to those in a buying phase. In addition, the CF, when the need arises, could borrow in the financial markets on the basis of the stock warrants and the callable capital pledged to it by the ICA's.

Differences between the G-77 version of a CF and ours—like the divergence of views on ICA's—reflect to a large extent differences in objectives. The G-77 look to commodity institutions to regulate markets largely so as to raise prices and effect transfers of resources from consumers to producers. Accordingly, endowing the CF with its own resources and putting financing in place before individual commodity agreements are negotiated would tend to diminish the chances that ICA's could effectively balance the interests of consumers and producers and adhere to the principles I laid out earlier. Principal-source and up-front financing in the common fund—

- Would mobilize financial resources that need not bear any relation to the requirements of ICA's eventually negotiated;
- Could allow the common fund to infringe upon the autonomy of ICA's by virtue of its central funding role;
- Allow governments who are not members of ICA's and who have no direct interest in the commodity concerned to gain leverage over the activities of ICA's;
- Allow financial resources of governments to be used for the financing of ICA's which the particular government has decided do not meet its requirements for membership; and
- Provide producers with the incentive to set unrealistic price ranges and/or negotiate other price-raising features; this would lead to a tendency for ICA's to maximize drawings from the CF at an early stage and reduce the financial viability of the CF.

All these contingencies create the danger that ICA's, at best, might be less effective than otherwise, and at worst, might actually operate in a restrictive way. Thus, the history of failure of commodity agreements could well be repeated.

While we see the possibility for a positive role for the CF in the area of non-buffer-stock measures, we believe that the G-77 proposal for the financing of a broad range of such measures is likely to prove to be a liability to the CF when borrowing in capital markets on behalf of the buffer stock activities of ICA's. Furthermore, it is likely to be wasteful of resources as it does not appear to take into account the considerable support existing institutions already give to such activities.

For example, during fiscal year 1978, the multilateral development banks lent over $1.1 billion for projects related to the 18 IP commodities. This represents a twofold increase over 1977. For the 5-year period 1975-79, the development banks have budgeted more than $4 billion for the production, development, and processing of those same commodities. In addition, the banks have played a major and rapidly increasing role in their lending for productivity improvement and downstream facilities. In fact, between 1975 and 1978 the emphasis in lending by the development

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banks for projects related to the IP commodities shifted markedly from product expansion to R. & D., productivity improvement, and processing, with the first falling from 80 percent of the total of such loans in 1975 to about 26 percent in 1978. This shift is helping commodity producers to diversify their productive capabilities in sectors threatened by global overproduction, or longer run declines in demand.

This does not mean that consumer/producer agreements and the CF could not play a constructive role in improving the marketing, production, and trading environment for commodities. There remains considerable scope for work in the areas of R. & D., the development of new end-uses, and other activities which would not duplicate the efforts of existing international agencies.

Finally, in defining the activities of commodity organizations, there is not just the problem of assuring efficient use of financial resources by avoiding duplicative efforts, but also that of comparative advantage. Thus, the development banks and national entities are better placed to decide on overall development objectives and priorities than can sector-oriented agencies, such as commodity organizations.

The role of markets

The effectiveness of realistic and adequately financed commodity agreements depends upon the existence of well-functioning markets, and particularly upon broad-based spot and futures markets. In a certain sense, futures markets and international buffer stocks are complementary in that they offer protection to sellers and buyers from the effects of unpredictable price fluctuations. However, buffer stock arrangements are designed to protect market participants from relatively extreme price fluctuations. For instance, the U.S. proposal for an international rubber agreement provides for a ± 20-percent adjustable price range. Most hedging operations, on the other hand, would seek protection from considerably smaller price fluctuations.

Furthermore, we believe that appropriate hedging by marketing organizations of producing countries in the futures markets could materially reduce their short-term price risks. Thus, the market can help to reduce short-term risks, while commodity agreements would help to reduce longer term risks. Together, the effect would be greater stability in the overall market. This in turn could increase supply and demand and thereby expand market activities. Nevertheless, as in negotiated agreements, there is need to guard against manipulative activities that would distort market operations to the benefit of few and to the detriment of others.

Indeed, it is the fear of such manipulative activities that has kept a number of potential participants from taking advantage of the risk-reducing opportunities provided by these markets. In the United States, the Commodity Futures Trading Commission is charged with minimizing the risk of manipulation. But, the ability of the market to exercise its proper and constructive function in the last instance remains in the hands of the participants.

Conclusion

The structure of commodity markets and the lessons that can be drawn from history suggest that restrictive commodity agreements and financing arrangements that curtail the play of market forces are unlikely to be successful for more than a few years. As such agreements begin to fail, they would create just the divisive issues between producing and consuming nations that participants are seeking to avoid. Therefore, the guiding principles of our commodity policy continue to provide for a wide latitude for the operation of market forces. This implies that intervention in the market by ICA's be confined to the smoothing of price peaks and troughs and that a CF, acting as a financial intermediary for ICA's, neither regulate nor otherwise intervene in commodity markets.

The benefits to be derived from well-structured price stabilization agreements and the financial and budgetary savings associated with an appropriately structured CF could be significant.

Even if consumers and producers, developed and developing countries, can agree on mutually beneficial objectives in the area of commodity agreements, the effectiveness of such agreements depends to a considerable degree on domestic policies in consuming and producing countries. Producing countries would need to

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assure an investment climate that does not work at cross-purposes with stabilization objectives. Thus, tax, financial, and general investment policies must allow the transmission of demand stimuli to producing sectors so as to achieve appropriate and timely supply responses. And in consuming countries, trade policies must allow demand to become fully effective and to be transmitted to the most efficient producers.

Finally, it must be remembered that international commodity arrangements are neither a panacea for solving the economic problems of the developing world nor can they offer more than a partial solution to international commodity problems.

Exhibit 55.—Statement of Secretary Blumenthal, May 17, 1979, before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce, regarding the Nation's energy crisis

Today I come before you to discuss our Nation's energy crisis—particularly as it relates to crude oil.

Nature of our energy problem

This Nation faces energy problems that strike to the core of our political and economic security, and affect the very stability of our society. The central problem is the availability and cost of crude oil. The story can be told by a few numbers. In 1970, the posted price of light Saudi Arabian crude, the key indicator of world oil prices, was $1.60 per barrel. Today the posted price is $14.54 per barrel, a nominal increase of 708 percent. In 1970, the United States met 76.7 percent of its crude oil needs out of its own production. Today, we meet only 50 percent of our needs from our own production despite gains from Alaska. In 1970, 72.7 percent of our oil imports were supplied by Western Hemisphere nations (primarily Canada and Venezuela). Today, less than 20 percent of our imports come from these countries. In 1970, our oil import bill was $2.9 billion. We now expect our 1979 oil import bill to be about $52 billion.

In 1958, 1975, and 1979, senior economic policy officials carefully examined, under section 232 of the Trade Expansion Act and its predecessor, whether our national security is threatened by the volume and character of our oil imports.[1] In each case the answer has been: Yes!

The national security elements are clear:

- Because so much of the oil used in the United States originates thousands of miles away, supplies are vulnerable to interruption for a variety of causes. As the oil embargo of 1973 and subsequent energy shortages have illustrated, interruptions in energy supplies seriously disrupt our economy.
- As our oil import bills have skyrocketed, our export growth has not been sufficient to balance our trade accounts. Large trade deficits have been the result, with the consequent risk of dollar depreciation. Excessive dollar depreciation can be extremely harmful to the American people because it increases domestic inflation and erodes personal income. Excessive dollar depreciation also hurts the entire world economy because the dollar is the dominant currency in world trade and finance.
- If we continue to rely more and more on uncertain foreign sources of oil, the independence and vigor of our foreign policy is put at risk.
- Cartel control of over 50 percent of the world's oil supply exacts an increasing drain on the real resources of the consuming nations. It jeopardizes their economic security and ability to plan their economic futures. With world prices dictated by political forces, rather than by free markets, sensible inflation control becomes extremely difficult for the consuming nations.
- Our increasing oil imports play directly into the hands of the world oil cartel and add to upward pressures on world oil prices. Our oil imports today constitute 17 percent of world oil production. Absent increases in non-OPEC

[1]Additional information is contained in "Report of Investigation Under Section 232 of the Trade Expansion Act, 19 U.S.C. 1862, as amended," directed to the President from Secretary of the Treasury Blumenthal, Mar. 14, 1979.

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energy supplies, or a reduction in world oil consumption, rising U.S. oil imports will directly tighten the world market and undercut efforts to encourage responsible and moderate oil policies by the OPEC nations.

- Finally, as escalating U.S. oil imports suggest, this country is not yet making a determined and creative transition to a world in which oil supplies are scarce, expensive, and often unreliable. We are continuing to use energy, and particularly oil, at a far too lavish rate, and we are failing to make those long-term investments in alternate energy technologies that will be essential to our economic and political security in the remaining years of this century.

These are enormous problems. President Carter, to his everlasting credit, has chosen to address them. Last year, with the National Energy Act, we took major strides to correct imperfections in our coal, natural gas, conservation, and utility rate policies. But the core issue—crude oil policy—was not resolved at that time. By failing to act in this area, we left in place a system of price controls and entitlements imposed on domestic oil production which aggravates our energy problems.

The system originated with the comprehensive wage and price controls instituted by the Nixon administration in 1971 and has operated in its present form since 1973. The system has grown steadily more complicated and, at the same time, has intensified our energy problems. It does so by disguising from the American people—consumers, investors, and industry alike—what we are all really paying for oil. Because of it, we use and import more oil than we should; we produce less domestic oil than we should; and we neglect to make economically sensible and necessary investments in alternative energy sources and technologies.

The oil-pricing system sets various ceiling prices for the domestic production of oil. Lower tier oil—production from fields in operation in 1973—is generally capped at about $6 per barrel. Upper tier oil—production from fields placed in operation since 1973—is capped at approximately $13 per barrel. The system also requires refiners to make payments—known as entitlements—to each other so that each refiner pays the same average price for a barrel of oil, regardless of the source of supply.

The results of these controls and regulations are rather obvious:

- The average price of oil to refiners, and thus to individual and industrial consumers of oil, is substantially less than the world price. For example, in February of this year, the country was facing a price of $15.80 a barrel for imported oil on the world market. But the controls-and-entitlements system established an average refiner price of $13.24 per barrel, regardless of source. As a consequence, there was an effective, federally mandated subsidy of $2.56 per barrel to import oil, rather than use domestic oil, and a like subsidy to consume oil, rather than to conserve it or use some alternative form of energy, such as coal, natural gas, or solar energy.
- The incentive to produce oil domestically is artificially depressed. About 40 percent of domestic oil has been subject to the lower tier cap of about $6 per barrel, and another 30 percent to the upper tier cap of about $13 per barrel. Compared to a world price of $15.80 per barrel in February, these controls constituted a straightforward signal to oil owners to invest in more profitable ventures, either here or abroad.

In brief, since the OPEC-generated explosion of oil prices in 1973, the United States has been operating a program that encourages oil consumption and imports and discourages domestic oil production and the development of new energy sources. Although this has been done in the name of "protecting the consumer," it has had precisely the opposite effect. By discouraging investments in domestic oil production and development of alternative energy sources, by enlarging the trade deficit and weakening the dollar, and by tightening world oil markets, these price control policies have added to upward price pressure not only on world oil prices but also on the general price level of all goods and services. Far from protecting the consumer, the domestic oil control system has instead served to aggravate inflation.

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The President's program

The President has recently addressed the critical problems created by our dependence on oil imports in the following ways:

By agreeing with our allies in the International Energy Agency to reduce U.S. imports (by the fourth quarter of 1979) by up to 1 million barrels a day below levels expected prior to the 1979 OPEC price increases. This action—and similar actions by our allies—should moderate future increases in world oil prices, reduce our trade deficit, and strengthen the dollar.

By phasing out price controls on domestic crude oil. This ends the subsidy to consumers of oil, encourages conservation and substitution of other energy sources, and provides appropriate incentives to expand domestic oil production.

By proposing a windfall profits tax. This captures for the U.S. Treasury some of the excessive profits from existing oil wells and a portion of future windfalls generated by OPEC price increases, and creates a mechanism through which the United States can offset the effects of decontrol on the poor, encourage energy-efficient mass transit, and further its efforts at developing alternative energy sources.

The decontrol program

The key element in the President's program is the decontrol of crude oil prices. The route chosen will delay as much of the inflationary impact of decontrol until 1981 or 1982 as is practicable while maximizing the incentive to increase production in 1979 and 1980.

The major features of the decontrol program adopted by the President are:

- Producers of lower tier oil (also called old oil) will be allowed to reduce the volume of output they are required to sell as old oil by 1½ percent each month in 1979 and 3 percent each month from January 1980 to September 1981 determined from new control levels established as of January 1979. This means that a property whose old oil control level is 100 barrels a day in January 1979 will be required to sell as old oil only 82 barrels a day in December 1979 and 46 barrels a day in December 1980. Production above these levels may be sold as upper tier oil.
- The price of upper tier oil will be phased up to the world price beginning on January 1, 1980, and ending on October 1, 1981.
- As of June 1, 1979, newly discovered oil will be decontrolled, as will that volume of production from any oilfield that results from introducing tertiary recovery programs.
- Production from marginal wells—that is, wells producing less than specified amounts of oil in 1978—will be allowed to sell at the upper tier price beginning June 1, 1979.

A key aspect of this program is the decontrol of old oil. From 1976 to 1978, oil price regulations gave the lowest return to those producers who made the greatest effort to increase production after the 1973 embargo, while giving the highest return to those producers who did the least to meet the national need after 1973. The decline rate change for lower tier oil announced by the President eliminates the disincentive to produce from old oil fields, since the profit earned from increased production in old oil properties will be the same as from investments in new oil properties. From the standpoint of production incentives, a rapid decline rate is the most efficient method of decontrolling lower tier oil.

A second critical element in the President's program is the decontrol of newly discovered oil and incremental production which results from the completion of tertiary recovery projects. No longer will exploration for new reserves in untapped areas be discouraged by a stifling system of price controls. Further, the incentive to invest in tertiary projects which involve risky efforts to apply expensive, experimental procedures to the recovery of additional oil from depleted reserves will be as great as the incentive to explore for newly discovered oil. This is as it should be in a competitive economy.

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The windfall profits tax

Decontrol is an essential step toward a sensible national energy policy. However, decontrol will create some windfall profits since, in many instances, the world price exceeds that necessary to induce rapid production and discovery. To recapture some of these windfall profits, while at the same time preserving production incentives, we have proposed a tax of 50 percent on the windfall profits per barrel generated by decontrol and by future OPEC price increases. An additional portion of the windfalls will automatically be recovered through existing Federal income tax laws.

Our tax involves a 50-percent levy on three bases: The windfall profits from moving lower tier oil to the upper tier; the windfall profits from moving upper tier oil to the world price; and the windfall profits from future real increases in the world price.

A. *Lower tier.*—The tax on old oil would be equal to 50 percent of the difference between the price at which the oil is sold and the control price of the old oil. The control price is currently about $6 per barrel and is to be increased by inflation.

The administration's tax on old oil is imposed on production which most likely would have come forth had controls remained in effect, so that genuine increases in production from old oil properties are not taxed. Specifically, the tax applies only to that volume of lower tier oil freed to the upper tier under decontrol which exceeds the volume of oil which would be freed under a 2-percent decline rate after January 1, 1980.

The decontrol plan uses a 3-percent decline rate while the windfall profits tax uses a 2-percent rate. The difference is dictated by economics. As I noted above, a 3-percent decontrol decline rate was required to provide the incentive of replacement cost pricing for old oil properties and also to allow for a smooth transition to complete decontrol in 1981. Had a lower decline rate been employed, the "gap" when complete decontrol is required in 1981 would have been larger and the inflationary shock in 1982 greater.

However, the 3-percent decline rate exceeds the actual decline rate observed in almost every oilfield. Thus, a 2-percent decline rate was selected for tax purposes as being closer to historical experience. Using a lower decline rate than 2 percent for tax purposes would obviously increase the amount of old oil subject to tax, but would risk discouraging production to some extent. The 2-percent decline for tax purposes represents a reasonable balance between capturing windfalls and assuring maximum production.

B. *Upper Tier.*—The tax on upper tier oil will be equal to 50 percent of the difference between the price the oil sells for and the inflation-adjusted price of upper tier oil. The tax would begin phasing out in November 1986 and would disappear by January 1990. The upper tier tax will have little if any adverse impact on production of upper tier oil since the control price was close to the world price before the recent OPEC surcharges.

The upper tier tax is phased out in order to simplify the windfall profits tax at a point in time when fine distinctions are no longer needed. Computing the upper tier tax requires reference to the last vestiges of price controls. Since revenue from the upper tier tax will decrease substantially after 1985 as the volume of upper tier oil diminishes, we decided to phase out the upper tier tax after 1986.

The upper tier tax excludes new production, incremental tertiary production, and any oil subject to the lower tier tax.

C. *Uncontrolled tier.*—The upper and lower tier tax bases will cover about two-thirds of U.S. production. The remaining third is composed of output from the Alaskan North Slope, stripper wells (wells that produce less than 10 barrels a day for a 12-month period), newly discovered oil, and incremental production resulting from the introduction of tertiary recovery procedures in old oil fields. These categories of production are *now* either decontrolled or effectively decontrolled, and thus are able to earn the world market price.

The third base of the windfall profits tax applies to this uncontrolled oil (other than Alaskan North Slope oil) to the extent not subject to the lower tier or upper tier tax. The 50-percent tax would be imposed on the difference between what the producer receives, and a base price of $16 per barrel as of January 1, 1980. The base would be

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adjusted for domestic inflation occurring after 1979. Eventually, the decontrolled tier tax would apply to all other domestic oil, as it is decontrolled.

A number of questions have been raised concerning the $16-per-barrel base price for the uncontrolled tier tax. The $16 figure is based on the estimated world price which would be in effect as of the first quarter of 1980 as a result of the December 1978 OPEC price announcement. The base price was calculated to allow for uncertainties about the difference between the posted price of Saudi Arabian marker crude, and transportation costs, quality differentials, and other relevant factors. By choosing $16, most domestically produced uncontrolled crude oil would pay no tax unless OPEC were to raise its prices in excess of inflation.

Second, it has been suggested that the $16 base be increased because recent OPEC surcharges have already increased the price of oil. However, the President's windfall profits tax proposal is designed to prevent domestic producers from benefiting from just these kinds of sudden price increases. There is no rational reason for exempting the profits domestic producers are realizing from these surcharges from the windfall profits tax.

Third, it has been argued that since the tax on the uncontrolled oil tier is permanent, the United States is permanently condemning producers to a lower price at home than they might realize abroad, and that the United States will produce less oil than would be produced in the absence of a permanent tax.

It is simply not true that producers can earn even more abroad than they can at home if the uncontrolled tier tax is enacted. In every other producing country, increases in the price of oil have immediately been accompanied by increases in taxes on producers or by nationalization. Either action deprives the producer of the increased revenues.

Moreover, those who argue that we will lose a small amount of domestic production due to the uncontrolled tier tax fail to recognize the risk of imposing no tax at all. Political forces will not allow complete and permanent decontrol of oil so long as we face an unqualified threat of embargoes and sudden price increases. In the absence of a permanent tax, a future surge in oil prices may compel a return to regulation. It is preferable to risk sacrificing the very small potential supply response in order to avoid such a situation. By imposing a permanent tax with a base which is adjusted for inflation, I believe we will, in the long run, allow producers to receive approximately the same price as is received outside the United States but with standby protection that will prevent them from receiving sudden windfall profits due to increases in prices as a result of anticompetitive cartel practices.

D. *Further comments.*—I would like to respond to some of the general questions that have been raised about the President's windfall profits tax proposal.

It has been suggested, and I believe misleadingly so, that the administration has proposed a "weak" tax. This is not so. Our goal is to capture windfalls without prejudicing production incentives. This we have done.

There are almost no exceptions to the upper tier tax. The only exception to the uncontrolled tier tax is the well-justified exclusion for Alaskan North Slope oil. The exceptions to the lower tier tax are geared to ensure maximum possible production from domestic sources, and old oil exempt from the lower tier tax is subject to the upper tier tax. Furthermore, the uncontrolled tier tax is permanent, and captures half of all increases in oil industry revenues which are due to price increases beyond that which would be allowed solely by inflation.

Absent our windfall profits tax, producers would receive $0.43 *net* from each dollar increase in revenue. *With* the tax, the producer's take drops to $0.29 per dollar. Assuming oil prices do not increase in real terms beyond 1979, the tax reduces by 30 percent the amount of money which the oil industry would actually keep as a result of decontrol. If oil prices were to increase in real terms, say, by 3 percent per year, the tax would reduce industry revenues from decontrol by 40 to 45 percent.

Assertions that the tax is weak have in some instances been based on misleading comparisons. For example, comparisons are made between the gross revenues generated from decontrol—before payment of any additional production costs and any taxes—and the *net* Federal tax receipts due to the windfall profits tax. These types of comparisons fail to take into account the automatic effect of other taxes and the increased expenditures for greater oil output. The proper comparison is between

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producer and royalty revenues *with* and *without* the windfall profits tax. Under this analysis, producer and royalty revenues are 30 to 45 percent lower with the windfall profits tax than without it.

It has also been said that the windfall profits tax denies capital required for further exploration. Such arguments are without economic foundation. The economic incentive is provided by the price of newly discovered oil, not by the cash flow from existing production. The argument for increased cash flow is untenable. It would lead to a cheap source of capital for those now engaged in the exploration for oil and gas while new entrants must pay the market price for capital. This is inconsistent with a competitive economy, because it would further impede entry by nonoil firms into oil production and thus reduce competition. Moreover, providing "free" capital means that the investment basis in oil property is reduced. To be consistent, the "cash flow" advocates should demand that such oil be sold at a lower price—or perhaps given away—since the investment has already been recovered.

A variation on the cash flow argument is "plowback." Plowback is an offset against the windfall profits tax for certain oil-related investments. Plowback should be recognized for what it is: a subterfuge for repealing the windfall profits tax. This tax is being sought in part because some of the increased profits from decontrol are windfalls that do not lead to appreciably increased domestic oil production. Likewise, plowback—which is merely a reduction in the tax—will not necessarily add to domestic oil production.

Proponents of plowback argue that it provides a useful subsidy for domestic oil production. However, as a subsidy, plowback is deficient. Since plowback would be limited only to present owners of oil, it would provide no incentive to new entrants into production. This would discourage competition in the industry and encourage concentration. Moreover, plowback subsidies would be distributed only to the *owners* of interests in the oil, such as royalty holders. Not all owners *produce* oil, and it is production, not mere ownership, which should be encouraged. In addition, plowback would require complex and arbitrary definitions of threshold or base period investment levels and of qualifying investments, leading to interminable administrative disputes and litigation.

Finally, some have challenged the windfall profits tax proposal on the basis that we subject no other windfall to a special tax. This argument ignores the very special circumstances of the domestic oil industry. Windfalls are most commonly found among commodities, such as oil. In most cases, however, competition and the legal structure of the market rest within the authority of the United States. This is simply not the case with respect to oil prices. The windfalls are attributable to the action of a foreign cartel, totally outside the legal control of the United States. There is simply no sound reason why we must stand idly by and permit windfalls to be reaped in the United States because of actions taken by a foreign cartel.

Energy security trust fund

The President has proposed to convert windfall profits derived from OPEC pricing into the direct advancement of energy technology, the development of energy-efficient mass transit, and for assistance to those least able to afford energy price increases attributable to decontrol. This will be done through the energy security trust fund.

The fund will consist of the proceeds of the windfall profits tax, and increased Federal income taxes attributable to decontrol during the deregulation period. The fund is an addition to, and not a replacement of, existing Department of Energy funding.

The cost of all fund programs will be limited to fund resources. The new programs will be undertaken only if the windfall profits tax is enacted. The cost of any new energy tax expenditures will be charged against fund receipts in order to control these subsidies more effectively. All spending programs financed from the fund will be subject to annual authorization and appropriation. Given available funds, additional initiatives may be undertaken to reduce U.S. oil import dependence.

The Treasury Department will be responsible for holding the fund, and for estimates of revenues and tax expenditures. On the basis of these estimates, and estimates made

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by OMB of other demands on the fund, the extent of fund resources available will be determined.

Economic impacts

We estimate that the additional inflation resulting from phased decontrol compared to retaining controls indefinitely amounts to about 0.1 percent in 1979 and averages 0.2 percent a year over the next 3 years. By 1982, the level of the Consumer Price Index will be approximately 0.75 percent higher with phased decontrol than if controls had been retained indefinitely.

These estimates assume that OPEC prices rise only as fast as world inflation. If world oil prices increase faster than world inflation, the inflationary impact of decontrol would be slightly greater. For example, if world oil prices increase 3 percent a year faster than world inflation, the level of the Consumer Price Index will be approximately 0.9 percent higher by 1982. Thus, the inflationary impact of decontrol is not very responsive to faster OPEC price increases. This is because price controls govern only a third of all U.S. oil consumption. The remaining two-thirds (imports, stripper production, and Alaskan oil) are already free to receive the world price.

These inflation estimates are based only on *quantifiable* decontrol effects, such as the higher prices of gasoline, heating oil, and goods manufactured from petroleum, and the induced impact on prices resulting from wage increases caused by cost-of-living adjustments made in response to the additional inflation. The estimates do not include any effects from reduced prices of nonenergy imports due to the strengthening of the dollar, and from the lower oil prices which would result from future world oil price moderation due to reduced U.S. demand. The excluded effects are simply not quantifiable. Since the nonquantifiable elements suggest lower inflation impacts, it is probable that our numbers overstate the effect of decontrol on inflation.

Decontrol will restrain aggregate demand and economic growth slightly over the next 2 years—by perhaps 0.1 percent a year. In later periods, fiscal and monetary policy can be adjusted to the needs of the economy as they develop, taking into account the specific economic impacts of decontrol and expenditures from the energy security trust fund.

The Department of Energy estimates that, relative to continued price controls, the President's program will reduce oil imports by about 370,000 barrels per day in 1981 and 950,000 barrels per day by 1985, assuming OPEC prices increase only with worldwide inflation. Should OPEC raise prices at a rate in excess of worldwide inflation, the oil import savings would be greater. DOE has estimated that imports would be reduced by 440,000 barrels per day in 1981 and 1,100,000 barrels per day in 1985 under a case where OPEC raised its prices at a rate which was 3 percent per year greater than worldwide inflation.

Conclusion

The United States faces a severe energy problem today despite recent corrective measures. At the root of our present energy problem is the price of oil. In the past we have refused to address this problem because of the windfall profits involved. We can no longer afford to avoid the issue. By artificially suppressing the price of oil, too much oil is consumed and too little produced; other efforts to solve our energy problem are frustrated; and less incentive to switch to other fuels or to conserve energy is provided.

President Carter has recognized this dilemma. He has acted to decontrol crude oil prices permanently by the end of 1981. He has also addressed in an effective manner the issue of windfall profits created by decontrol.

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Exhibit 56.—Statement by Hazen F. Gale, Director, Office of Raw Materials and Oceans Policy, June 7, 1979, before the Subcommittee on Oceanography of the House Committee on Merchant Marine and Fisheries, regarding H.R. 2759, the Deep Seabed Hard Minerals Resources Act

I am pleased to appear before you today to convey the Department of Treasury's views on H.R. 2759, the Deep Seabed Hard Minerals Resources Act. As you know, the administration has presented its position on deep ocean mining legislation on a number of occasions during the last Congress as well as this one. Treasury has worked closely with other agencies in developing that position which supports the general objectives of H.R. 2759. I would like, however, to comment on specific provisions under titles I, II, and IV. Some of these were submitted previously in a report by the Department to interested House committees.

Construction and operation of vessels

The administration, including the Department of Treasury, strongly opposes section 103(C)(3), which requires at least one transportation vessel be documented under the laws of the United States. This provision would inflict an additional and unnecessary financial burden on the companies engaged in mining the seabed and would reduce the competitiveness of U.S. firms vis-a-vis firms from other countries and land-based producers. Therefore, this provision is inconsistent with a stated purpose of the act: to insure orderly and efficient development of deep seabed resources.

The potential deterrent to U.S. investment involved in this provision can be illustrated by a report prepared for the Commerce Department in 1978 entitled "The Relative Costs of U.S. and Foreign Nodule Transport Ships." It concluded that the operating costs of a U.S. documented and manned ore carrier were more than 40 percent higher than of a similar vessel documented and manned by a European nation. These higher operating costs of U.S. manned and registered vessels would raise the costs of products derived from seabed minerals. To avoid these higher costs, such provisions could induce U.S. seabed mining firms to operate under the umbrella of other jurisdictions.

In regard to recovery and processing vessels covered by section 103(C)(2), we support provisions for ships to fly the U.S. flag or the flag of those reciprocating states which have agreed to give the United States enforcement jurisdiction when their mining vessels are actually recovering nodules under a U.S. license or permit. A provision to prohibit documentation by a reciprocating state would be unfair and unwise policy toward several countries whose firms are involved in international consortia with U.S. firms. Potential seabed mining states would likely pass similar legislation, thus ruling out the prospect of compatible and workable reciprocal legislation. For these reasons, we strongly oppose any provision which would exclude mining and processing vessels from states qualifying for reciprocating state status. Moreover, this would be incompatible with the international character of the ocean mining industry.

Investment protection

Section 201 under title II sets forth the congressional intent with respect to an international agreement and section 202 addresses the effects of an international agreement. Specifically, section 201 states—

- That seabed mining legislation should be transitional pending implementation of a Law of the Sea treaty or other treaty relating to the deep seabed;
- That an international agreement should recognize access to hard mineral resources by U.S. citizens and it should recognize the right to continue established operations; and
- That the acceptability of an international agreement should be judged by the totality of its provisions.

Section 202 provides that—

- Regulations consistent with an international agreement will remain in effect when a treaty enters into force;

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- Investments by U.S. citizens will be protected whenever possible when implementing the international agreement; and
- One year after an agreement enters into force, the administration will report to Congress on the effect of the agreement on deep seabed mining operations.

In testimony before the 95th Congress, the administration consistently opposed investment guarantees as inappropriate and it continues to hold this position. We believe such guarantees are inappropriate because the Government should not guarantee investments against potential adverse consequences of future U.S. laws and treaties. This does not mean, however, that we oppose any safeguards for those miners who undertake mining in the interim period. The administration has instructed its negotiators at the Law of the Sea Conference to obtain provisions in the teaty that will allow U.S. miners to continue operations without significant changes in the investment environment.

With respect to the investment provisions in the bill before us, we recommend alternative language. The administration strongly supported the language reported in the 95th Congress by the Senate Foreign Relations Committee in its consideration of S. 2053, rather than the language passed by the House in H.R. 3350 in 1978 and now incorporated in H.R. 2759. A discussion of the Foreign Relations Committee language may be found in Senate Report 95-1180.

The administration assumes that this committee does not intend to imply an obligation to compensate mining firms for possible impairment of investments under a treaty. Nevertheless, we still believe that the Senate Foreign Relations Committee language concerning rights of the firms is more appropriate than sections 201 and 202 of H.R. 2759 since the former leaves no implication of an investment guarantee. That alternative language directly emphasizes that companies should be allowed to continue their operations under a Law of the Sea treaty or any treaty relating to deep seabed mining. In addition, it recognizes that the treaty may impose different obligations than contained in U.S. legislation. Consequently, the language establishes a broader test of acceptability of a treaty—one based on the degree of new economic burdens placed on them rather than on the "similar terms, conditions and restrictions" in H.R. 2759. The alternative language would be more consistent with our objectives of assuring the ability of firms to continue established operations. We also believe that the reporting obligations imposed on the executive branch by section 202 of the Foreign Relations Committee language are more consistent with these objectives than section 202 of H.R. 2759.

In view of these considerations the Department of the Treasury, on behalf of the administration, strongly recommends that the Senate Foreign Relations Committee language be substituted for the existing title II in H.R. 2759.

Revenue sharing

We view the revenue sharing requirement in title IV as an obligation in lieu of payments which would ordinarily be made to the owner of the mineral rights in exchange for the right to remove the resource. The Department of Treasury and the administration support these requirements as a measure of the U.S. commitment to the principle that the nodules belong to the "common heritage of mankind." Accordingly, the taxes imposed under section 402 are to be credited to the revenue sharing trust fund established under section 403 with the intention of sharing them with the international community, subject to appropriation.

It is now quite clear that a Law of the Sea treaty will contain revenue sharing provisions and the U.S. Government has accepted that principle. We believe the revenue sharing provisions included in this legislation will make it clear to U.S. companies that their operations will have to provide for future payments to the international community from the beginning of commercial operations. Knowing this they can structure their investment and operating plans accordingly.

The proposed section stipulates that a permittee will pay 3.75 percent of the imputed value of the minerals recovered from the seabed to the special Treasury account. We believe this is a reasonable obligation which will demonstrate the United States' commitment to the principle of benefit sharing. The rate is modest, especially since it applies only to the value of the nodules after they have been recovered from the

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seabed, which we have estimated to be 20 percent of the value of metals sold. We think it inappropriate to apply international revenue sharing to the transportation, processing, and distribution activities which are outside the seabed resource area. The U.S. delegation will continue to pursue this principle of limiting the base for computing revenue sharing obligations to the seabed mining sector.

Treasury supports the inclusion of section 404, in H.R. 2759 which would insure that nothing in this act shall affect the application of the Internal Revenue Code of 1954, as amended, or the Tariff Act of 1930, as amended. This language means that if a seabed mining company would not qualify for a depletion allowance, a foreign tax credit, or some other tax benefit under present law, it cannot argue that H.R. 2759 has conveyed that benefit. Similarly, we would want to retain the language relating to the application of customs or tariff laws.

Location of processing plants

Finally I want to say that Treasury supports the provisions in section 103(C)(5) as giving the Secretary of Commerce adequate guidance in issuing regulations on the locations in which a permittee may process nodules recovered from the deep seabed. This section is vastly improved over some earlier bills which would have severely limited the firms' freedom to locate plants efficiently. Consequently, the viability of the ocean mining industry will be increased, and the benefits of these activities will be more widely distributed.

International Monetary Affairs

Exhibit 57.—Statement by President Carter, November 1, 1978, regarding measures to strengthen the dollar

Last week, I pledged my administration to a balanced, concerted, and sustained program to fight inflation. That program requires effective policies to assure a strong dollar.

The basic factors that affect the strength of the dollar are heading in the right direction. We now have an energy program; our trade deficit is declining; and last week I put in place a strong anti-inflation program. The continuing decline in the exchange value of the dollar is clearly not warranted by the fundamental economic situation. That decline threatens economic progress at home and abroad and the success of our anti-inflation program.

As a major step in the anti-inflation program, it is now necessary to act to correct the excessive decline in the dollar which has recently occurred. Therefore, pursuant to my request that strong action be taken, the Department of the Treasury and the Federal Reserve Board are today initiating measures in both the domestic and international monetary fields to assure the strength of the dollar.

The international components of this program have been developed with other major governments and central banks, and they intend to cooperate fully with the United States in attaining our mutual objectives.

Secretary Blumenthal and Chairman Miller are announcing detailed measures immediately.

Exhibit 58.—Joint Statement by Secretary Blumenthal and G. William Miller, Chairman of the Board of Governors of the Federal Reserve System, November 1, 1978, regarding measures to strengthen the dollar

Recent movement in the dollar exchange rate has exceeded any decline related to fundamental factors, is hampering progress toward price stability, and is damaging the climate for investment and growth. The time has come to call a halt to this development. The Treasury and Federal Reserve are today announcing comprehensive corrective actions.

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In addition to domestic measures being taken by the Federal Reserve, the United States will, in cooperation with the Governments and central banks of Germany and Japan, and the Swiss National Bank, intervene in a forceful and coordinated manner in the amounts required to correct the situation. The United States has arranged facilities totaling $30 billion in the currencies of these three countries for its participation in the coordinated market intervention activities. In addition, the Treasury will increase its gold sales to at least 1½ million ounces monthly beginning in December.

The currency mobilization measures, described in the attached annex, include drawings on the U.S. reserve tranche in the IMF, for part of which we contemplate that the General Arrangements to Borrow will be activated; sales of special drawing rights; increases in central bank swap facilities; and issuance of foreign-currency-denominated securities by the U.S. Treasury.

Fundamental economic conditions and growth trends in the four nations are moving toward a better international balance. This will provide an improved framework for a restoration of more stable exchange markets and a correction of recent excessive exchange rate movements.

ANNEX

U.S. Measures for Mobilizing Balances of Deutsche Marks, Yen, and Swiss Francs

	$billion
A. Actions in the International Monetary Fund:	
1. Drawing of U.S. reserves tranche	3.0
(United States would draw deutsche marks and yen totaling the equivalent of $2 billion immediately. An additional $1 billion equivalent drawing would be made shortly thereafter, for which GAB activation would be contemplated.)	
2. Sale of special drawing rights	2.0
B. Actions increasing Federal Reserve swap lines:	
1. Increase in swap lines with Bundesbank to	6.0
2. Increase in swap line with Bank of Japan to	5.0
3. Increase in swap line with Swiss National Bank to	4.0
C. Issuance of foreign currency denominated securities up to	10.0
TOTAL	30.0
(Of this total, approximately $1.8 billion has been utilized in earlier operations under Fed swap lines, but the total excludes Treasury swap facility with Bundesbank.)	

Exhibit 59.—Remarks by Under Secretary for Monetary Affairs Solomon, November 6, 1978, before the B'nai B'rith Mining and Metal Industry, New York, concerning the international economic situation

Tonight I want to talk primarily about the international economic situation, but also about some directly related aspects of the domestic economic situation. I have the feeling that all of us Americans are uncertain, even confused, about where we are going—about what's going wrong with the economy and also what is going right.

The starting point for understanding where we are going and what is going right and wrong is the U.S. decision to establish an open international trade and capital system after World War II. This decision was taken in recognition that the severe and protracted depression of the 1930's was due much more to the trade barriers that we and others erected than to the financial panic of 1929. That post-World War II decision by the United States was a brilliant and far-reaching one. The United States had the influence to persuade the rest of the free world to join us in this approach and the power to implement it for both our own and the world's prosperity.

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This open international economic system was clearly the basis for rapid and sustained increases in our own wealth and standard of living, for the reconstruction and unprecedented growth of the other industrialized countries, and for progress—even though somewhat more limited—in the developing countries. The trade side of this open international system was implemented progressively through mutual reductions in tariff barriers which stimulated world trade and catalyzed high and sustained domestic growth in all the key countries. The other main catalyst was the open capital part of the system, which was equally critical to the prosperity and steady growth achieved by the United States and other countries. U.S. direct investment abroad, the availability of our capital markets to international borrowers, the freedom of our banks to lend abroad, all combined to provide much of the credit (as well as much of the management technology) that fueled very rapid growth in the rest of the world. Open trade and capital policies were directly and indirectly major forces in our own prosperity, but our actions in implementing the system changed the course of the rest of the world as well.

What has been the result of the open trading and capital system and associated worldwide growth? An increasing and incredible degree of economic interdependence, especially among the industrialized countries, whose internal industrial and agricultural structures are now heavily dependent on foreign sources and markets.

At the end of the 1960's and during the 1970's, the great postwar record of growth, employment, and prosperity ran into trouble. You are all familiar with the beginning of inflation as we escalated and poured more resources into the Vietnam war; the devaluations of the early seventies; the simultaneous boom in the industrial countries, feeding rapid increases in commodity prices worldwide; the shock of a fourfold increase in oil prices—all followed inevitably by very severe world recession in 1975.

Since 1975, the growth paths of the key countries have diverged sharply. We in the United States have achieved a vigorous recovery, adding 10 million jobs and increasing industrial production over 30 percent. Europe and Japan have experienced only sluggish growth, with rising unemployment, at least until recent months. In these respects, we have clearly done better than the rest of the world. But because of the open trading and capital system, and the continuing increase in interdependence, some things have gone wrong here at home:

- Our rapid growth and increasing output has led to a very rapid climb in our imports, while slower growth in the economies of our trading partners has meant slow growth in our exports.
- The slack in production capacity abroad has made our competitors push harder than ever to sell in the faster growing U.S. market.
- And, back in 1975–76, the combination of our recession and the erroneous judgment that we would be hurt less than others by the oil price increase caused the dollar to move up sharply in the exchange markets. Imports became cheaper and our exports less competitive. But the full effects of such exchange rate changes take 18 months or longer to show up in the trade accounts and, in 1977 and 1978, those earlier exchange rate changes contributed to our large trade and current account balance of payments deficits.

The other thing that has gone wrong is that U.S. inflation is worsening. Through most of the 1970's we had been averaging about 6¼ to 6½ percent inflation which—although very damaging—was not as bad as the performance of most other industrial countries. But beginning last year and even worse this year, various factors—including the declining dollar—increased our inflation rate to where (along with Canada's) it is the highest of the major industrial countries. While some downward adjustment of the dollar from the highly appreciated levels of 1975 and 1976 was appropriate to reverse the erosion in our export competitiveness, excessive movements contributed to an inflationary psychology—with dollar declines contributing to inflation, and with expectations of more inflation pushing wages and prices up and the dollar down even farther. Expectations of more inflation became cemented into our national thinking.

The gradual reduction of trade barriers, and the greatly increased volume of capital ready to move around the world at the push of today's sophisticated communications buttons, have come to mean that differences among the key countries in real growth

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and inflation now have a much more immediate impact on the direction and magnitude of trade flows and capital movements, We and the rest of the world are therefore more vulnerable now than in the past—this is the price we pay for the higher wealth and standard of living that the open world economy and increasing interdependence have brought. Today, import and export flows, even in the U.S.—which is the least externally dependent among major countries—are over 15 percent of our GNP. There is no way of retreating, either sharply or gradually, from this interdependence, without causing major disruption to our economy. An effort to retreat would bring major shortages in some industries, major gluts in others, and high unemployment. And we would, of course, forfeit the benefits yet to come from continuing our open and interdependent system.

So what can we do?

1. We can try to coordinate better the performance of the major countries, to achieve more balance and convergence of domestic growth rates and reduce inflation differentials. We have made some progress as a result of efforts at the Bonn summit. Growth rates are becoming better balanced. Next year, the other key countries will finally be growing at higher rates than the U.S. economy. They will be growing somewhat faster than before, and we will be tapering back after 3 years of very fast and sustained recovery. That tapering off does not mean a recession.
2. We must curb inflation at home.
3. We must reduce our dependence on imported energy, and we must improve our competitive response to export opportunities.
4. We must stop the decline of the dollar and correct some of the recent excessive drops. Some exchange rate changes were justified as national growth rates and inflation levels diverged significantly, but what we have seen recently is excessive and not justified by fundamental factors or trends in underlying economic conditions.

We are now moving forcefully on all these fronts. The undertakings at the Bonn summit are succeeding in bringing about a better balance of growth among the major countries. Our energy legislation is at last in place. We have initiated programs to improve our export performance. And the President has most recently announced comprehensive new policies on inflation and the dollar.

Why didn't we move before on the dollar? Because our timing had to be right if the effort was to work—we had to make a realistic judgment about the success of a major and bold move. Various factors went into that judgment—a key one was the improving trend in our trade and current account balance of payments deficit. Although there will be some increase in the present quarter due to special factors, we can now envisage a major decline in the current account deficit for 1979, which is the key figure to look at. If one assumes for estimating purposes that there is no change in oil prices, next year's deficit may be only one-third the 1978 figure. The underlying trend in our payments position was therefore improving, and it was evident that the markets were beginning to be ready to respond to forceful and sustained action on various fronts. It may, of course, take some time before all the people who move money around are convinced of our determination, and before we can return to a more normal pattern of two-way trading fully eliminating the mutually infecting psychology that it is a one-way street down for the dollar. The response to our actions has been impressive even in the short time since the announcement. And I would expect that the response will deepen and solidify as we pursue the various components of the anti-inflation and dollar programs with determination and with all the powers the Government can muster.

Now, what about the trade aspects of our system? First, we should recognize that the target depth of tariff cuts agreed on by the industrial countries last September was 40 percent, to be stretched out over 10 years. Since average tariffs now applied to industrial trade by the major countries range from about 7 to 15 percent, we can envisage at most reductions of only a fraction of 1 percent annually in average tariff levels. The major success in reducing tariffs in the past—as well as the move to more flexible exchange rates—means that we are today living in a very different trading environment. It is important to continue our efforts to reduce tariffs in order to sustain our longrun policy direction and continue progress on high tariffs in particular sectors

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and certain countries. But the focus of attention in the multilateral trade negotiations is clearly shifting—most importantly for the United States, to the negotiation of codes to reduce or eliminate nontariff barriers which have become the major impediments to trade.

Secondly, we must strive for a balance in trade policy between, on the one hand, fostering a dynamic economy and an industrial structure that can adapt to changes in comparative international efficiency, and, on the other hand, avoiding shock and disruption to domestic industry. Adjustment is essential—but in certain industries more time is needed for an orderly change. The problem becomes bigger if countries prevent adjustment by employing permanent subsidies which give their exports an unfair advantage and by providing permanent protection against imports for inefficient industries. These practices are a breeding ground for the kind of trade conflict we had in the 1930's. Only *transitional* assistance by government to industry, which will lead to a positive adjustment, is an appropriate policy and is in everyone's interests.

That is the entire rationale of the U.S. Government program for steel with which my name is associated. The trigger price system, designed to prevent unfair dumping in violation of our trade laws, is necessary only during a time of world steel glut when slack capacity abroad induces foreign steel manufacturers to sell in the U.S. market at below their production cost. The trigger price system is not a minimum price—anyone who has production costs lower than the trigger price levels is free to sell steel at those costs in our markets. Insofar as injurious dumping is successfully deterred, it will, of course, firm prices in the market. But any effective program would have this result. With the right balance of fiscal and monetary policy, and with a moderation of expectations about inflation through gradual moderation of wage and price decisions, the government and the private sector, cooperating together, can demonstrate that preventing unfair dumping—and enhancing fair competition—is not inflationary.

The other parts of our steel program emphasize modernization and cost savings that are beneficial to the steel industry and the American public and are achievable through nondiscriminatory actions which do not distort trade. The reduction in the depreciable guideline life on taxes and the loan guarantee program at commercial interest rates are designed to improve cash flow and provide capital to smaller firms for modernization of competitive plants. Our review of environmental policies and procedures will achieve basic environmental goals but at less cost to industry—and will benefit all industries, not just steel.

Before I close, I would like to make one comment on the intermixture of trade and capital flows and their effects upon exchange rates which we have seen reflected in the recent excessive declines in the dollar. We sometimes hear criticism from abroad about the so-called dollar overhang—criticism that the $600 billion in dollar-denominated assets held abroad is a result of U.S. profligacy, of a consistent history of spending beyond our means. This criticism does not square with the facts. Our net balance of trade in goods and services in the postwar era has been in surplus. Between 1960 and mid-1978, we had accumulated a net *surplus* on our current account balance of payments of some $34 billion. Therefore, the origin of the foreign dollar holdings has been investment and foreign borrowing, much of it financed in the open U.S. capital market, to fuel economic growth abroad. The U.S. economy has benefited from these flows, as have foreign economies. More broadly, the openness of the system as a whole has contributed to the political stability of the major nations, in startling contrast to the political situation in the 1930's as economies deteriorated and withdrew from each other. The United States may have exercised a dominant influence in the economic area during the postwar period, in bringing others to share our vision of a better world. But we were not economic imperialists—we did not enrich ourselves at the expense of others, but shaped a system from which all could gain.

Furthermore, if one looks into that figure of $600 billion in dollar-denominated assets held abroad, roughly $300 billion are foreigners' dollar claims on *other* foreigners and not on us—simply because the dollar was used as the currency for transactions between non-U.S. residents. Against the remaining $300 billion that are a true claim on U.S. residents, we have larger claims on the rest of the world—over $380 billion, though some are less liquid.

The United States must bring inflation under control through the ways I have indicated and intensify the trend toward eliminating rapidly the current account

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balance of payments deficit. As we do so, and as foreign demand for credit revives with faster foreign economic growth, the current talk abroad of "unwanted dollars" will disappear once again, as it has on many occasions before. The U.S. economy is the strongest in the world, and the perception of that reality will not be clouded for much longer by our temporary problems. Our policy objectives will be prudent and balanced—but our implementation will be as vigorous and bold as the situation may require.

Exhibit 60.—Statement by Secretary Blumenthal, December 14, 1978, before the Subcommittee on International Economics of the Joint Economic Committee, concerning actions taken on November 1, 1978, to strengthen the dollar at home and abroad

Introduction

Mr. Chairman, it is a particular pleasure to appear here today to discuss the actions announced by the President, Chairman Miller, and myself on November 1, 1978, to strengthen the dollar at home and abroad. The actions were taken in the context of persisting inflation and financial market conditions—domestic and international—which reflected doubts about the determination of this administration to stop inflation and defend the value of the dollar.

Our actions should allay these doubts. We have committed the major tools of economic policy to the task of unwinding the inflation that has plagued us for the past decade. Let there be no mistaking our determination: There will be no waffling and no wavering. We intend to persist because controlling inflation is absolutely essential to the achievement of the social and economic goals which are at the core of President Carter's policies.

Obviously, the dramatic circumstances in which the November actions were taken should not overshadow the very important measures taken earlier to deal with our fundamental economic problems. Each of these measures must be seen as part of an integrated array of policies. Any one of them alone is not sufficient, but together I believe they do the job.

The economic situation we faced in October

Even with the full force of economic policies addressing the inflation problem, it will not be an easy or a painless task to reduce inflationary pressures. Inflation has become deeply ingrained in our society, and in the expectation on which private sector decisions are based. And as inflation has persisted and accelerated, there is the threat of adding demand-pull pressures to the worst elements of cost-push forces.

In the early stages of recovery from the 1974–75 recession, the persistence of a high underlying rate of inflation, despite significant slack in resource utilization, reflected largely a pattern of wages-chasing-prices-chasing-wages. As the recovery from the recession continued, and as inflation persisted, an overall environment of inflationary expectations was fostered, with the expectation of further inflation distorting costs, prices, the structure of production, and decisions on saving and investment.

To the intensifying expectation of further inflation have been added some signs that real pressures on resource availability may be emerging—scattered signs to be sure, but still troublesome. The economy has maintained strong momentum since the winter lull of 1977; real growth has averaged close to a 4-percent annual rate this year, and in some sectors of the labor market and in some industries, demands have begun to press on available resources. While the overall unemployment rate has remained close to 6 percent during much of the year, unemployment among skilled workers and others characterized as part of the "prime labor force" has declined. For example, the unemployment rate for married men, at 2.5 percent, is not far above the rate during most previous periods of peak labor demand. Nonunion wages have been rising more rapidly this year than union wages, reflecting both the strength of demand factors in the labor market and the increased minimum wage. The employment rate (the ratio of people employed to the working-age population) continues to rise.

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While industrial capacity utilization overall has remained in the area of 85 percent—leaving some margin for expansion—capacity limits are approaching for some industries. Moreover, the official statistics may be overstating the extent of spare capacity that can be utilized in a cost-effective manner.

It has become increasingly clear that, in recent months, the economy has entered the zone of resource utilization within which demand pressures are more easily translated into rising prices. Thus, there is a danger of adding demand-pull to the existing cost pressures.

Moreover, the inflation has incorporated a new "feedback" mechanism: As the rise in domestic prices weakened the dollar, this has resulted in higher prices for imported goods and, through an "umbrella effect," in higher prices for many domestic products competing with imports. Perhaps as much as 1 full percentage point of inflation this year reflects the effects of the depreciation of the dollar, and this has given the inflationary spiral a further turn.

The combination of inflationary expectations, emerging demand pressures, and the domestic price effects of a weakening dollar have been reflected in an acceleration in the underlying rate of inflation. Over the past 3 months, wholesale prices rose at about a 10½-percent annual rate; even excluding food, the rate was near 8 percent. Consumer prices rose at nearly a 9-percent rate in the last 3 months, at a 9½-percent annual rate excluding food. The growing pessimism about inflationary prospects was reflected in financial markets. Stock prices fell precipitously in the last 2 weeks of October, and prices of long-term debt instruments also declined.

In the foreign exchange market, severe and persistent disorder and excessive declines in the dollar were undermining our efforts to control inflation and were adversely affecting the climate for continued investment and growth in the United States. In the month of October the dollar declined sharply against virtually all major currencies. The dollar fell against the Swiss franc by 6 percent, the Japanese yen by 7 percent, and the German mark by 12 percent. The trade-weighted dollar fell by 8 percent. All told, in the 13 months preceding the November 1 initiative the dollar had fallen 38 percent against the Swiss franc, 34 percent against the yen, and 26 percent against the DM.

As November approached, it became clear that the market was failing to take account of the improvements that were being made in the underlying conditions that determine the dollar's value. The administration had inherited a budget deficit of over $66 billion in 1976, or roughly 4.4 percent of GNP; it was paring the budget for 1980 to $30 billion or below, roughly 1 percent of GNP. Energy legislation had been passed which would result in savings of at least 500,000 barrels per day by 1979 from levels that might otherwise be expected. The volume of trade flows had begun to reflect improvements in our competitive position. The trade balance of the United States had receded to a $31 billion annual rate in the second and third quarters of the year from a $45 billion rate in the first and was heading further down. The Nation's surplus on investment income and other service transactions had grown sharply. The outlook for the current account was dramatically improved, allowing us to predict with confidence that it would drop by 50 to 60 percent from the $17 billion in 1978 to as little as $6 billion in 1979. And to reinforce these trends, the President had instituted a determined anti-inflation program and an enhanced national export effort. Yet the dollar continued to be sold. The psychology of the market during the month of October was such that these favorable developments in underlying economic conditions, and administration statements reaffirming its determination to follow through on our anti-inflation program, were unable to halt a wave of pessimism about the prospects for the dollar.

The consequences of a continued deterioration of the dollar were grim. The precipitous decline of the dollar threatened to erode our anti-inflation effort. Foreign official and private portfolio managers were already showing signs of selling off U.S. securities and would have been tempted to sell more, further disrupting the stock and bond markets. Dollar holders abroad would have been encouraged to sell more of their outstanding dollar holdings for assets denominated in other currencies. The OPEC countries would have been pressured to substantially raise oil prices to recoup excessive dollar losses. The world economy—indeed, the whole world financial system—would have been impaired—and with it, the economy of the United States.

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The leadership of this Nation in world affairs, political as well as economic, would have been severely damaged.

We could not tolerate this situation. Firm action was needed to strengthen the dollar both at home and abroad.

Our November 1 actions

Thus, on November 1 we took the direct and forceful measures that were needed. You are familiar with the specific measures announced on that date. They entailed—

- A $3 billion increase in reserve requirements on large certificates of deposit and a rise in the discount rate by a full 1 percent;
- An increase in Treasury's monthly sales of gold to at least 1½ million ounces per month, starting with this month's auction;
- A decision to join with Germany, Switzerland, and Japan in closely coordinated exchange market intervention;
- The mobilization of $30 billion in DM, Swiss francs, and yen to finance that portion of the intervention undertaken by U.S. authorities.

The U.S. financing involves an approximate doubling of Federal Reserve swap lines with the central banks of Japan, Germany, and Switzerland, to a total of $15 billion; U.S. drawings on the IMF of $3 billion; U.S. sales of about $2 billion of special drawing rights; and issuance by the Treasury of foreign-currency-denominated securities in amounts up to $10 billion.

Most of the foreign currency resources have already been mobilized. The increase in the central bank swap lines took effect immediately on announcement. Drawings on the IMF in deutsche marks and Japanese yen amounting to the equivalent of $2 billion and $1 billion were made on November 6 and 9. We sold about $1.4 billion equivalent in SDR's for deutsche marks and yen on November 24. The first tranche of DM-denominated securities, about $1¼ to $1½ billion, will be issued tomorrow.

By so massing a sizable and broad-reaching pool of resources, we intend to signal to the world that the dollar had been pushed too far and that the U.S. authorities were determined to correct the situation.

The results of our measures

Mr. Chairman, reaction to our measures has been good. I believe there is a realization among governments, and in the financial community as well as in the general public, that the U.S. Government is determined to deal effectively and decisively with our economic problems—that we will act to bring inflation under control; that we wtll strengthen the dollar at home and abroad.

This regeneration of confidence in the dollar rests on the measures announced November 1 and on the reaffirmation by the President of his determination to exercise fiscal austerity. Let me repeat that the President intends his 1980 budget to be tight, with a deficit of $30 billion or less. A balanced budget is now a realistic goal for the years thereafter.

Coordinated with this thrust on the fiscal side is the increasing restraint being exercised by monetary policy. Monetary policy is the responsibility of the Federal Reserve and it should stay that way. But the administration has a view as to how it should be managed. Let me make clear our view. It is that monetary policy has to dovetail with tight fiscal policy. Monetary policy must be kept tight until inflation has been brought under control. In concert, the major tools of economic stabilization will be used in support of the President's wage-price deceleration program to attack the causes, not just the symptoms, of inflation.

It is too early, of course, to see a reflection of recent policy actions in the statistics on inflation. But we have seen a change in the confidence exhibited in financial market behavior. The stock market has recovered some of its October losses, as have the prices of long-term securities. In fact, though some short-term rates have risen nearly a full percentage point since the November 1 announcement, interest rates on long-term instruments have remained relatively unchanged. This suggests an improvement in inflationary expectations over the longer term.

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Some apprehension is being expressed that the program may become *too* effective and throw the economy into recession. There are risks, to be sure—economic forecasting is at best an imprecise art—but certainly the risks of recession *with* the program are far less than the *certainty* of recession if inflation were allowed to accelerate unchecked. Indeed, the program we have launched is the best guarantee for avoiding recession.

Although recent inflation rates have been in, or near, the double-digit range, the economy retains fundamental strength and good balance. Real economic growth so far this year has been almost 4 percent and there are few distortions in the composition of output. Employment continues to grow at an exceptionally strong rate. The most recent data on retail sales show that consumers are still in a buying mood. Inventories remain in good balance with sales. The flow of new orders for durable goods—particularly for nondefense capital goods—is high and order backlogs are rising. Housing activity continues at a high rate of over 2 million new starts; the introduction of a new financial instrument, the money market certificate, has enabled thrift institutions to compete for funds and maintain the supply of funds in mortgage markets. Our exports, particularly of manufactured goods, have been rising substantially while our imports, other than of petroleum, have risen more slowly.

These are not the symptoms of a sick economy, unable to sustain momentum under the weight of fiscal and monetary restraint. Rather, these are signs of a strong economy approaching the realistic limits of resource capacity which needs and can afford some moderation in pace.

The President intends to bring inflation down and keep it down. He realizes that this is the only sure way to maintain and increase the standard of living for all Americans, especially the poor and the elderly who depend on fixed incomes. We cannot at this stage in the economy opt for growth at the expense of inflation. Restraint on the monetary and fiscal fronts now must be pursued to assure real growth later. Fortunately the economy is strong and able to withstand the discipline that is required.

It is apparent that this commitment to responsible economic management is beginning to take hold. We are beginning to see a change in tone, a modification in expectations in the foreign exchange and domestic money markets. As the full realization of the extent of our measures and the degree of our determination to persevere spreads, I believe we will see further dollar strength in the markets.

In summary, Mr. Chairman, the response here and abroad to the measures announced November 1 has been very encouraging. The announcement has been interpreted rightfully as a signal that we are determined to deal effectively and decisively with the inflation which is our primary economic problem and to maintaining the strength of the dollar. That interpretation is correct. We are fully committed. We will persist as long as is necessary to control inflation. We will exercise tight budgetary restraint, maintain responsible domestic monetary policies, implement effective wage-price guidelines, and work for stable, orderly conditions in the foreign exchange markets. This is the right way, and the only way, to achieve our basic economic goals.

Mr. Chairman, let me now turn to addressing some specific concerns.

The first involves our intervention objectives.

The shift in intervention practices announced on November 1 was aimed at correcting a particular situation. Our objective is to restore order and a climate in the exchange markets in which rates can respond to the economic fundamentals, in this case to the improved outlook for the fundamentals that underpin the dollar's value. We are not attempting to peg exchange rates or establish targets or push the dollar beyond levels which reflect the fundamental economic and financial realities.

On the subject of the competitive position of U.S. exports, let me make one thing absolutely clear. There are those who feel that continuing decline in the dollar is good for trade. This is a dangerous misconception. The United States does not need to pursue dollar depreciation to buy market position. To have argued on October 30 or to argue now for more dollar depreciation as a way of correcting our trade deficit is a simplistic and nonsensical view that could force a collapse of an open capital and trading system. The administration firmly rejects such tactics.

Second, Mr. Chairman, you ask in the press release that announces these hearings why differentials in interest rates between the United States and other strong countries

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would be any more effective now than before in attracting capital. The answer lies in investor expectations about the future. The key to attracting investment is to offer investors a real rate of return. While nominal interest rates have been high in the United States, inflation has rendered them negative in real terms. If investors are being offered the promise of less inflation and a real return on their investments, it should be easier to attract the capital needed to finance our current account deficit.

Third, your staff has questioned the Treasury decision to issue $10 billion of foreign-currency-denominated bonds.

To reiterate, the Treasury did announce its intention to issue up to $10 billion in securities denominated in foreign currencies. The first of these issues—for 2½ to 3 billion DM—will be issued tomorrow. We plan a Swiss franc issue in January, and we are also giving consideration to a yen-denominated borrowing in Japan in 1979.

It is important to realize that these securities are being issued only for the purpose of acquiring foreign currencies for the intervention effort. They are not intended as an effort to "mop up" unwanted dollars. They are being sold only to residents of the country issuing the currency in which the securities are denominated. We are seeking to minimize the extent to which purchasers switch out of dollars to effect these purchases.

There were important reasons for including foreign-currency-denominated securities in our package. The issuance of securities with, in the case of DM, 3- to 4-year maturities provides us with additional foreign currency resources, for a longer time period, and gives assurance to the market that the United States will not be pressured to reverse its intervention operations too soon because of its need to accumulate the foreign currencies needed to repay swaps. In addition, the issuance of these securities demonstrates that we are firmly committed to strengthening of the dollar over time and that we will use all means at our disposal.

With the issuance of foreign-currency-denominated notes, there is the potential for exchange rate gains and losses. The calculation of the total "cost" of such borrowing must take into account the interest rate differential between domestic and foreign markets, as well as possible gains and losses because of exchange rate changes. Of course there is a risk. But the alternative cost to the economy of failing to move with adequate and comprehensive measures constituted an even greater risk. If you will permit me, Mr. Chairman, this is a case of being pennywise rather than pound-foolish. The importance of assembling a comprehensive and credible package to strengthen the dollar justifies the lesser risk we have assumed.

Finally, there is the question of the role played by the IMF in our November decision. The actions we took on November 1 were fully in keeping with our obligation "to assure orderly exchange arrangement and to promote a stable system of exchange rate * * *" by "fostering orderly economic growth with reasonable price stability." Since part of the November 1 package consisted of a reserve tranche drawing from the IMF and sales of SDR's, we of course discussed these plans with the Fund management prior to the announcement. The U.S. program was also explained subsequently to the IMF Executive Board in connection with activation of the General Arrangements to Borrow (GAB) for financing part of the U.S. drawing. The proposal was supported by the IMF and the GAB participants. On December 13 the Board discussed the U.S. program in more detail, under IMF surveillance procedures, and expressed support for the U.S. action.

Mr. Chairman, you have also asked whether the IMF has undertaken to reduce the key currency status of the dollar. And questions have been raised as to whether reduction or elimination of the dollar's role as a reserve currency would remove pressure on the exchange rate and make domestic restraint less necessary.

Let me make two points. First, any such fundamental change in the international monetary system would have far-reaching effects on other parts of the system and could not be considered in isolation. Nor could such a restructuring of the system be simply mandated by the IMF—it would require detailed study and negotiation, looking toward arrangements that would be acceptable to all countries. We would need to know what system we would be moving to before dismantling the one we have. There were extensive studies of possible changes in the monetary system earlier in this decade, many of which would have meant a sharply reduced reserve role for the dollar. Ultimately, none of these changes appeared practical or widely desired. I

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stress this point not because we are unwilling to consider change but because the full implications of such change need to be recognized and assessed.

Second, the United States is going to be in difficulty if it continues to run an inflationary economy, regardless of the reserve role of the dollar, and no reform of the system can obviate the need for us to pursue policies of restraint to counter inflation, or to maintain a reasonably strong external position.

As international economic and financial relationships evolve, the role of the dollar can be expected to evolve to reflect changes in underlying economic realities. There is widespread agreement on progressive development of the SDR's role in the system, and other currencies may also take on a larger role. But such changes will come about gradually over an extended period of time and they must come about in an orderly manner. As a practical matter, the dollar will continue to play an important role in international monetary relationships for the foreseeable future if the world is to continue to achieve growth and progress. Accordingly, it is our duty to manage the dollar in a manner which befits its central role in the system. This is precisely what President Carter, Chairman Miller, and I intend to do.

Exhibit 61.—Remarks by Under Secretary for Monetary Affairs Solomon, January 12, 1979, at the Royal Institute of International Affairs, London, entitled "The Evolving International Monetary System"

Much of the past year was characterized by major international monetary unrest. Continuing large payments imbalances among the industrial countries were accompanied by serious exchange market disorders which ultimately required forceful and internationally coordinated counteraction. These disturbances have given rise to a widespread feeling that our monetary mechanisms are not working as well as they should. Various ideas for change have been advanced. The year also saw major modification of the formal structure of the monetary system, with implementation of amended IMF Articles of Agreement and the move toward new monetary arrangements within the European Community. The new IMF provisions, and the Community's efforts to develop closer monetary cooperation and greater economic stability, offer substantial promise for a more smoothly operating international monetary system in the future.

Today I would like to discuss these developments and suggest some implications for the future evolution of the system.

My starting point is an appreciation that the international economic imbalances and tensions of today stem in large part from the successes of the post-World War II decision—a brilliant and far-reaching decision—to work toward creation of an open and liberal system of international trade and payments. Catalyzed by progressive trade liberalization and lubricated by international capital flows, the postwar global economy brought rapid and sustained increases in the wealth and living standards of the industrialized countries and progress in the developing countries. A further result of movement toward an open system of trade and capital was an increasing and unprecedented degree of international economic interdependence, particularly among the industrial countries, whose industrial and agricultural structures are now heavily dependent on sources and markets abroad. And this increasingly complicates management of the system.

Toward the end of the 1960's and during the 1970's, the great postwar record of growth, employment, and prosperity ran into trouble. We are all too familiar with the acceleration of inflation as the United States escalated and poured more resources into the Vietnam war; with the shocks to the system associated with the multilateral exchange rate realignments of the early 1970's; with the simultaneous boom in the industrial countries feeding rapid increases in commodity prices worldwide; with the oil embargo and massive increases in oil prices of 1973–74; and with severe world recession of 1974–75.

We have been living for much of this decade not only with destructively high levels of inflation worldwide but with sharply divergent rates of inflation and real growth among the industrial countries. Because of the major reduction of trade barriers and the greater ease with which capital can move across international boundaries,

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differences among the industrial countries in growth and inflation can now have not only a much larger potential effect, but also a much more immediate effect, on the direction and magnitude of trade and financial flows—and on the exchange markets. Our greatly increased interdependence has brought all of us greater wealth and a higher standard of living than would have been possible otherwise. But these gains have not been without some cost. We have had to pay a price—we are all far more vulnerable now than in the past to developments abroad and to the operations of the international economic system.

The developments of 1978 pointed up this vulnerability with great clarity, and posed challenges in two closely related but distinguishable areas. First, we should consider whether changes in our existing monetary arrangements are practical and desirable. Second, and more fundamentally, we must develop better ways of bringing our economic policies and performance into greater harmony, in an effort to reduce or avoid the internationally disruptive impacts of sharp divergences in domestic economic performance.

The international monetary system, and the exchange market in particular, is a principal focal point for the pressures arising from our interdependent world economy. Understandably, international monetary arrangements have also become a focal point for proposals to alleviate those pressures. Some have proposed that targets or zones for exchange rates be established and pursued by monetary authorities. Others have proposed limitations on international capital flows as a means of attaining greater monetary and exchange rate stability. Still others see the major role of the dollar in international reserves as a principal source of international monetary difficulty and have suggested that steps be taken to reduce the reserve role of the dollar. Let me comment on these three separate but not necessarily independent questions.

Exchange market developments over the past year or so have unquestionably posed serious problems. We have seen that when there is uncertainty about the validity of basic economic policies of major countries, the exchange markets, left to themselves, can generate a psychological atmosphere in which rates may be carried beyond what can be justified by any objective standard. But does that fact—and I believe it is widely accepted as a fact—mean that the world now can or should move to a much more highly structured set of arrangements for exchange market intervention?

In the case of the United States, the decline of the dollar under disturbed and disorderly conditions last fall threatened to undermine our anti-inflation efforts and to damage the climate for sustained investment and growth in the United States and abroad. Our action on November 1, jointly with Germany, Japan, and Switzerland, to embark on a major program of coordinated intervention, was specifically a response to what was and had been happening in the exchange markets. But in order to be successful, that response had to fit into a broader context—a context composed of comprehensive U.S. policy measures to correct its domestic economic problems, and clear prospects for a very strong improvement in the U.S. external position between 1978 and 1979.

The United States is now acting forcefully to deal with its inflation problem. Fiscal policy has turned decisively toward restraint. As will be affirmed in the next few days, the President is tightening even further in the fiscal 1980 budget, with a deficit of under $30 billion, or barely more than 1 percent of GNP—which compares with deficits currently averaging about 4½ percent of GNP in the other major industrial countries. Monetary policy is complementing fiscal restraint, as evidenced by a further pronounced rise in interest rates and welcome slowdown in growth of the principal monetary aggregates. And these measures of demand restraint are being supplemented importantly by wage and price standards, which are gaining a broad measure of support and compliance on the part of the American people.

We anticipate a very sharp improvement in the U.S. current account position between 1978 and 1979. It will reflect the combined consequences of a number of factors, including our rapidly improving export performance, implementation of our energy program, and slower growth in the United States coupled with faster growth abroad. Even with the recently announced oil price increase, we expect the deficit to be reduced very substantially in 1979.

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We recognize that our inflation problem is destructive to our domestic performance and objectives as well as to our external position. That problem did not arise overnight, and it cannot be solved easily or painlessly. But overcoming it is the policy of the U.S. Government, and the President is determined to persevere and to succeed.

We were encouraged by the initial response to the November 1 program, and we are encouraged by the better balance in the markets that has emerged lately. We believe that program will provide a framework of greater stability and order, in which the markets can react positively to the strengthening of the underlying U.S. position. In implementing the international aspects of the program, we have greatly intensified and deepened our consultations on exchange market policy and operations with the other countries involved. This process has been of great value to us in analyzing and assessing exchange market developments, and we look toward a continuation of the close consultations and cooperation that have been engendered by this effort.

But important as that cooperative initiative was, we knew that our intervention efforts could succeed only if underlying conditions were moving in our favor, and if we had the policies in place to assure they would continue to move in our favor. Our judgment was that a bandwagon effect was depressing the dollar excessively, well out of line with fundamental economic factors and without regard to the fact that policies were in place to bring about a basic improvement in our position. Timing was essential, and I do not believe the intervention program would have been warranted or successful if those preconditions had not been met.

In short, large-scale intervention can be useful and effective under circumstances of serious disorder, when the basic requirements for greater stability have been met. But it would be a mistake to interpret the November 1 program as a departure from a policy of permitting exchange rates to reflect fundamental factors in different economies—rates were not reflecting such factors. The November 1 initiative does not imply that such intervention can succeed in holding exchange rates against fundamental trends or that efforts to do so would be desirable. Rather, the experience of the past several months reinforces our view that appropriate economic and financial policies must be in place if there is to be meaningful and lasting stability in exchange markets. And I believe that is a view that is fully appreciated and, indeed, frequently expressed, by participants in the exchange markets themselves.

Second, the potential for very large international capital flows, with their important implications for exchange rate movements, has led some to feel that greater official control over capital flows could provide a useful technique of exchange market stabilization. Our own experience in the United States with capital controls in the 1960's and early 1970's does not provide any assurance that controls would offer a feasible approach. Moreover, it seems to me to be an approach that removes a critical element of the foundation of our open and interdependent global system, and that could erode the tangible economic gains that have been achieved over the past decade. Finally, it is an approach that assumes capital flows should not be permitted to influence exchange rates—that only the movement of real goods and services should affect rates. I have great difficulty in accepting this idea.

I do feel that steps can be taken to expand and improve information about world money markets, and perhaps to strengthen official influence over those markets. Consideration can usefully be given to whether steps might be taken to bring banks operating in the Euromarkets more completely and explicitly under the regulations and supervision of national banking authorities. There is, I know, a feeling on the part of some that the Euromarket is unanchored and unregulated. This is a considerable exaggeration. For example, branches of U.S. banks operating abroad—a substantial component of the Eurocurrency market—are subject to U.S. reporting requirements and bank examination procedures, as are domestic operations of U.S. banks. Moreover, the BIS is currently working to expand and improve its reporting arrangements and data collection in an effort to provide a basis for more complete understanding of the Euromarkets. But there may well be further steps that could be taken to strengthen bank supervision and mitigate the impression that the market has explosive potential.

Finally, there is a view that the reserve role of the dollar, and the very large volume of foreign official holdings of dollars, constitute an important source of instability in the international monetary system. This view has led to various proposals—for

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funding or consolidating dollar balances, for an increasing role in the system for the SDR, and possibly for a European currency unit or for greater use in reserves of other national currencies such as the deutsche mark and Japanese yen.

I personally have some doubts that the existence of foreign-held dollar balances, official or private, represents the major part of the problems and instability which have affected the dollar. Certainly sudden changes in the level of these balances can and at times do add to pressures in the exchange markets, but there is ample scope for capital movements and exchange market pressures quite independent of the existing stock of foreign balances. While moves toward funding or consolidation of foreign official dollar balances might have some positive impact, it seems to me that they are not the root cause of exchange market disorder or dollar instability.

Let me make clear that the United States has no interest in artificially perpetuating a particular international role for the dollar. The dollar's present role is itself the product of an evolutionary process. We would expect the dollar's role to continue to evolve with economic and financial developments in the world economy, and a relative reduction in that role in the future could be a natural consequence.

At this juncture, it is difficult to predict just what evolutionary changes may take place in the years ahead, though we can foresee certain possibilities. Certainly we would expect the SDR to take on a growing role in the system. The world has recently taken important steps to increase the role of this internationally created asset, by widening the scope of operations in which it can be used, by strengthening its financial characteristics, and by the decision to resume allocations of SDR after a period of 7 years in which no allocations were made. We in the United States have great hope for the progress of the SDR. As experience with the asset accumulates, as allocations continue over a period of time, and as the usability of the instrument increases, we believe it will fulfill the promise which its creators foresaw and play an increasingly more valuable role.

Another possibility is that certain national currencies will play an increasing role. Indeed an expansion of the reserve roles of the deutsche mark and Japanese yen has occurred over the past decade in both absolute and relative terms. I would note that the authorities of other countries have generally tended to discourage use of their currencies as reserves, largely because of concern about the implications for domestic money supply and a fear that domestic financial management will be made more difficult. Whether such attitudes persist will presumably have an important bearing on future developments, as will questions of size and accessibility of nondollar capital markets.

A new possibility for international monetary evolution is posed by the EC's current efforts in the international monetary area. At least in the initial phase, the focus of these efforts is principally on arrangements for intervention and settlement among participating EC countries. However, there is the possibility that in time a European currency unit may develop as a reserve instrument of broader interest and use.

We are prepared to consider with an open mind these and possibly other ideas for evolution of the reserve system. Such ideas may offer potential for a reduction in the relative role of the dollar, and that prospect is not in itself troublesome to the United States. We do not live in a static world, and we must adjust to changing circumstances. We will not resist change, but rather will be concerned to insure that any change be an improvement and that it be accomplished smoothly and in a manner which strengthens our open international trade and payments system.

In each of these aspects of our international monetary arrangements—the exchange rate system, the international capital markets, the reserve system—the United States is fully prepared to cooperate with others to consider where improvements might be possible. But I do not believe that possible action in any of these areas—or indeed in all of them—will solve the fundamental problems facing the system. As I see it, the basic problem is a different one: how to coordinate better the economic performance of the major countries, to reduce inflation rates and inflation differentials, and to manage domestic growth rates so as to bring about a better balance in global economic relations.

This is not a shortrun problem but a continuing one. There is no magic, overnight solution, and the task of international policy coordination ultimately can raise highly sensitive issues of national sovereignty. Nonetheless, I believe it is the real task we

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have to address if we are serious about maintaining our open system and about achieving greater stability in international economic relations.

We do not lack institutional opportunities for pushing ahead with this effort. The industrial countries meet regularly in various bodies of the OECD, and heads of state have met with increasing frequency to discuss common economic problems. Most recently, the IMF, in its new Articles of Agreement, has been given potentially important powers of surveillance over the operations of the international monetary system and the balance of payments adjustment process.

The basic problem facing the system is recognized clearly in the new IMF provisions on surveillance, which stress that the attainment of exchange market stability depends on development of underlying economic and financial stability in member countries. These provisions equip the IMF with major potential to address the problems of policy coordination with a view to achieving a more sustainable pattern of payments positions among its member nations and a more smoothly functioning international monetary system. The IMF's focus encompasses not only exchange rate policy, narrowly defined, but also domestic economic policies as they affect the balance of payments adjustment process. The IMF has enhanced capability to advise not only countries in balance of payments difficulty, but also countries in surplus, on the international implications of their policies and on approaches they might appropriately follow to correct their payments imbalances—a symmetry of approach we believe is essential to an effectively functioning system.

Progress in implementing the IMF's new surveillance role has been cautious and deliberate. This is understandable, given the very short time these powers have existed. But we believe the time has come for the IMF to move more vigorously to fulfill its potential in this area, and we intend to support it in that effort. I have no doubt that the Fund's new provisions afford the international community a framework for policy coordination that can be made effective. The potential is there. The question is whether governments will permit—indeed, help—that potential to develop. If they are willing, the prospects for sustained monetary stability and maintenance of our open, interdependent system are good.

We need, in effect, a new attitude—a recognition that if nations want the benefits of an interdependent world with freedom of trade and payments, they must be prepared to give up some of the freedom they have enjoyed to manage their domestic economies without full consideration of the international environment. As part of an interdependent world economy, each country must accept greater responsibilities to exercise its economic management to coordinate better its policies and performance with those of other countries. Whatever the institutional arrangements, unless nations are prepared to accept these responsibilities of interdependence, they cannot expect to continue to receive its full benefits.

The potential role of the emerging European monetary arrangements should be viewed against broader evolution of the system. The European effort is inspired fundamentally by an objective of ultimate political and economic unification, an objective that is unlikely to be adopted on a global basis for many years to come. Against the background of that objective, the EC is making an ambitious and laudable move to make progress in many of the areas I have touched on today. Most importantly, participating EC nations are attempting to achieve meaningful economic policy coordination in an effort to reduce imbalances within the Community and create conditions for greater exchange market stability.

The EC's efforts on a regional level can make a major contribution toward progress in the broader global effort to manage international economic interdependence, and we offer the EC every encouragement in attaining its objectives. We have asked only that Europe bear in mind the interests of nonmembers and of the broader system, particularly the critical need to develop the role of the IMF in the system. We have been assured that this will be the case.

In conclusion, I feel that the developments of the past year point clearly to the need for improvement in our international economic arrangements. We can and will consider with others whether improvements are possible and desirable in the more mechanical aspects of those arrangements. But improvements in our monetary mechanisms cannot solve the more fundamental problem facing the system, the need for governments to improve their international economic policy coordination out of

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recognition of their own self-interest in preserving our interdependent system. We believe this must be the focal point of our efforts and offers the only real prospect of lasting stability.

Exhibit 62.—Statement by Assistant Secretary Bergsten, January 30, 1979, before the American Metal Market Forum on Gold and Silver, New York, N.Y., on U.S. gold policy

As the representative of a major supplier of gold to the private market, I welcome this opportunity to participate in your forum on the outlook for gold. Recent U.S. Government actions will have an important bearing on the gold market. It is therefore especially appropriate at this time to discuss the relationship of the U.S. Treasury gold sales program to long-term U.S. gold policy, and to our current efforts to establish the fundamental conditions for a strong dollar at home and abroad.

The U.S. gold sales program

The sale of U.S. gold to the private market was initiated in 1975 in reponse to the demand for gold that developed in anticipation of the elimination of restrictions on gold ownership by Americans. In order to reduce the possible adverse impact on the U.S. trade balance, two auctions were held at which 1.3 million ounces of gold were sold. When the expected demand for gold by U.S. citizens failed to materialize and the speculative pressures faded, the sales were suspended.

The current program of monthly sales dates from May 1978, with the amount auctioned increased from 300,000 ounces at each of the first 6 sales, to 750,000 ounces in November and then to 1.5 million ounces in December, January, and February. Our November 1 announcement indicated that sales would involve at least 1.5 million ounces monthly until further notice.

These sales serve three important U.S. objectives:

- They help reduce the U.S. trade deficit, which has been a major factor in the weakness of the dollar.
- They respond directly to conditions in the gold markets, which have contributed to the adverse psychological atmosphere in the foreign exchange market which has undermined international monetary stability.
- They promote the internationally agreed effort to reduce gradually the monetary role of gold.

The expansion of the sales program to at least 1.5 million ounces monthly was announced on November 1 as part of a comprehensive U.S. effort to achieve the fundamental economic conditions for a strong dollar at home and abroad. In the context of the broad array of policies being pursued—monetary and fiscal restraint, a voluntary wage-price program, an energy program, expanded export promotion, and active intervention in the foreign exchange market—the sale of U.S. gold can make a useful supplementary contribution.

Most Americans probably do not realize that the United States had become a large net importer of gold. Production of gold from domestic sources—including scrap—has been running at 2 million ounces annually but domestic demand is well in excess of that level. Thus we have a substantial gap which, in the absence of U.S. Treasury sales, can only be met by imports.

In 1977, net imports amounted to 9½ million ounces at a cost of $1.5 billion to the U.S. trade position. In the face of rising demand last year, the sale of nearly 4.1 million ounces from U.S. stocks provided a balance of payments saving of about $800 million. At the current monthly level, the sales would be well in excess of the 8½ million ounces, valued at $1.5 billion, of net imports in 1978 and could turn us into a net gold exporter—helping the U.S. trade position at an annual rate of up to $4 billion at current market prices.

The sales program is proceeding smoothly. Indeed, the amounts bid have been well in excess of our offerings. The average price received at recent auctions has varied by about $2 per ounce from the price at the second London fixing on the day of the

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auction for bars of comparable fineness. The principal participants in the Treasury auctions have been recognized gold dealers which buy and sell gold as part of their normal business activities. The largest successful bidders have been banks and dealers from Germany, the United States, Switzerland, and the United Kingdom. No foreign government or central bank has purchased gold at the U.S. sales.

The fact that most of the gold has been purchased by foreign-owned firms does not mean that all of this gold has been transferred abroad. These firms act as wholesalers and distributors of gold in the United States as well as abroad. There is also a great deal of location-swapping of gold to minimize shipping costs abroad. Thus, a large portion of the gold sold to these firms has remained in the United States to meet domestic needs.

The type of gold being sold at the auctions reflects the general composition of U.S. stocks. Three hundred and 400-ounce bars have been offered because they are the standard size in Treasury stocks. We don't sell gold in smaller quantities because we do not now hold significant quantities in less than 300-ounce bars. Only high-fineness gold bars containing at least 99.5 percent gold—the type traded in the private market—were sold in the monthly auctions in 1978. Sales of gold bars containing 90 percent fine gold were initiated in the January auction because 70 percent of the U.S. gold stock is in that form. The response to the sale of 500,000 ounces of these lower quality bars was very favorable. The bids received totaled 1.3 million ounces; and the lower average price received—about $1.50 per ounce—largely reflects costs needed to refine these bars into bars of the quality normally traded for industrial use. Obviously such bars are sold on the basis of the weight of the gold they contain rather than the total weight of the bar. We currently expect to continue sales of this gold in subsequent auctions.

Since the minimum sale at our auctions is for a 300-ounce bar, only a handful of individuals have submitted bids. Although the opportunity to purchase gold in small quantities is readily available in the private market, Congress decided last year that the small American investor should be given the opportunity to buy gold from the U.S. gold stocks. Legislation was enacted in late 1978 providing for the issuance over a 5-year period of two types of American Arts Gold Medallions, containing one-half ounce and 1 ounce each of gold. At least 1 million ounces of gold in medallion form are to be offered each year. If Congress appropriates funds for their production and distribution, the sales could take place in the spring of 1980. It is expected that 500,000 ounces of gold would be struck in medallions of each size for the 1980 sales program.

The expanded gold sales program announced on November 1 is open-ended with regard to both amount and duration. The United States has no particular price objective for the program, and continuation of the sales is in no way contingent upon the attainment of any particular price level. The magnitude and number of sales will continue to be based upon our assessment of the U.S. balance of payments outlook and conditions in the foreign exchange market.

The market outlook

The supply of newly mined gold coming on the market has been fairly stable since 1976 at about 40 million ounces annually, of which South Africa has accounted for 23 million ounces and the Soviet Union for an estimated 8.5 million ounces. The remainder of the supply reaching the market reflects sales from official stocks and has increased each year. In 1978 total sales from official stocks amounted to about 16 million ounces, of which the International Monetary Fund accounted for about 6 million ounces, the United States about 4 million ounces, and other countries, including the Soviet Union, about 6 million ounces.

Continuation of U.S. gold sales at the present level would make the United States the second largest supplier of gold to the world market this year. Assuming that sales by other suppliers continues at recent levels, the total supplies reaching the market would amount to about 70 million ounces in 1979, an increase of about 25 percent from last year.

In assessing the demand side of the market, account must be taken of two different factors and how they respond to changing economic conditions: Industrial and commercial demand and investment-cum-speculative demand.

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The *industrial and commercial demand* for gold generally follows a pattern similar to that of other metals. When the economy is growing rapidly, industrial and commercial demand for gold will expand. When the price rises rapidly, particularly in relation to the prices of other metals which can be used as substitutes, demand in this segment of the market slackens.

The impact of U.S. gold sales on this sector of the market is difficult to ascertain, given the many other factors operating. For example, the economy will be growing at a more moderate pace in 1979 which will slow demand. In addition, speculative and investment demand is highly volatile. However, an increase in supply of the order of magnitude of current U.S. sales might be expected to reduce the clearing price in this portion of the market from what it otherwise would be.

The *speculative and investment demand* for gold largely reflects an attempt to hedge against financial or political instability and is therefore influenced primarily by expectations regarding inflation and future gold prices and by political unrest. The runup in gold prices in dollar terms last year was associated with concerns about accelerating U.S. inflation, which was also a major factor contributing to the decline of the dollar in the foreign exchange market. The U.S. commitment to bring down the rate of inflation should therefore have an important effect on this segment of the market.

The growing purchases of gold coins, however, which more than doubled last year to 3½ million ounces, and the rapid expansion in gold futures trading, no doubt reflect an increased investment and speculative demand for gold by U.S. citizens. Nevertheless, investment in gold bullion appears to have remained minimal in view of the large amount of funds that must be tied up in a non-interest-bearing form and the cost of buying and storing gold.

For most Americans, investment in gold remains a highly risky proposition. Given the extreme volatility of gold prices, gains and losses are extremely sensitive to the timing of transactions. For example, if an American had purchased gold when restrictions on ownership were lifted in 1975, the subsequent rate of return would have been less than 4 percent annually—less than could be obtained on U.S. savings bonds.

Of course, much larger gains or losses could have occurred with a different time frame. However, the variability of rates of return on gold investments far exceeds that of financial instruments of comparable maturity. For example, if 3-month gold investments had been made at the beginning of each quarter from July 1973 to July 1978, the rate of return would have been negative in nearly half of the 21 investment periods. Since the beginning of 1975, when restrictions on ownership of gold by U.S. residents were eliminated, the range of losses and gains on 3-month investments would have been -58 percent to +451 percent. Comparisons on 6-month and 1-year investments reveal a similar, albeit less drastic, variability.

U.S. gold policy

At the outset, I noted that the U.S. gold sales program is consistent with longstanding U.S. policy of gradually phasing out the monetary role of gold—a policy which has been formally accepted internationally for several years. This policy is based on the widely recognized view that gold, or any other commodity, is inherently ill suited as a basis for a stable national or international monetary system.

Natural forces limit new gold production at the same time that expanding private uses appropriate a growing share of available supplies. Hence the residual supplies for monetary purposes are inadequate for, and unrelated to, the liquidity needs of an expanding national or world economy. Commodities are simply an unsuitable monetary instrument.

Furthermore, the extreme price volatility of gold would make it a highly unstable standard. The price of gold moved from a peak of $195 per ounce at the end of 1974, to a trough of $104 in mid-1976, back to a new high of $243 last October and to $195 after the U.S. dollar measures were announced on November 1. To have required economies to adjust to such fluctuations would have led to swings in employment, output, and prices which no government could or should tolerate.

Within the United States, the demonetization of gold has been proceeding for an extended period with broad bipartisan support. The legislative measures removing the

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domestic link between gold and the domestic money supply were enacted under President Roosevelt in 1933–34. The provision for a gold certificate reserve against required bank reserves was gradually reduced and finally eliminated by legislation introduced by President Johnson in 1968. Action to terminate the convertibility into gold of dollars held by foreign monetary authorities was taken in August 1971 by President Nixon. Legislation authorizing U.S. acceptance of the IMF amendments which formally removed gold from a central role in the international monetary system was introduced by President Ford and approved by Congress in 1976. Market sales of gold from U.S. stocks were begun by Secretary Simon and resumed by Secretary Blumenthal.

Other countries have also virtually eliminated any meaningful domestic monetary role for gold. No important country allows its money supply to be determined by the size of its gold stocks. There is also agreement among nations that the monetary role for gold internationally should be reduced, although there is a recognition that the international role of gold will have to be phased out very gradually because too many countries have a sizable percentage of their official reserves composed of gold.

The recent amendments to the IMF Articles of Agreement—the rulebook for the international monetary system—adopted by nearly all members, provides concrete action to phase out gold's monetary role. They abolish the official price of gold and remove gold from its position as numeraire for the system. Gold is virtually eliminated as an instrument in IMF transactions. Provision is also made for the future disposition of the IMF's remaining gold holdings.

The IMF is already in the process of disposing of one-third of its gold holdings, with 25 million ounces being sold at public auctions for the benefit of developing countries and a further 25 million ounces being distributed to members in proportion to their quotas at the old official price. The IMF is in the third year of its program, which is scheduled to be completed in 1980. Thus far, 17.6 million ounces have been sold at 29 public auctions with $2.1 billion obtained for the developing countries. There have been three IMF distributions of gold totaling 18.4 million ounces, of which the United States received 4.3 millin ounces.

There is no evidence that central banks are interested in building up their gold reserves through purchases in the private market. Since the United States terminated the commitment to buy gold at a fixed price in 1971, transactions between central banks in gold have been few and far between—limited primarily to a few instances of gold collateral loans. Some countries have revalued their gold holding to obtain bookkeeping profits or increase the reported level of their reserves. However, there is general recognition that the market price could not be realized if global stocks were sold to the private market and the volatility of the market price has left the countries quite uncertain as to what value to place on their gold holdings. Consequently, practices vary quite widely from country to country.

Finally, although IMF members have acquired gold from the IMF under the agreed "restitution" program at the old official price, only a handful of the eligible developing countries have purchased gold at market prices at the Fund auctions. Even some of these purchases have been made to facilitate sales to the domestic private market and have not led to an increase in central bank holdings.

Basically, central banks have been unwilling to acquire gold at market-related prices because the volatility of the private price and the inability to sell large amounts without sustaining heavy losses have made gold a very risky asset. In fact, IMF data suggest that, in addition to the United States, other IMF members may have disposed of about 15 million ounces of official gold holdings since 1971.

Some have suggested that the new arrangements under the European Monetary System represent a departure from this trend, and will result in a significantly increased monetary role for gold. It is clearly premature to reach any final judgment on the effect of the EC decisions, inasmuch as the arrangements are not in operation. However, there is no reason to believe that the European arrangements and intentions constitute any revival of a monetary role for gold. No official price of gold is established and there is no requirement of official gold settlements. The ECU will not be convertible into gold at a fixed price. Participants will retain title to the deposited gold, and must reacquire their gold at the end of the transition period. The EC

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envisages that gold would actually be pooled at a subsequent stage, although specific arrangements have not been agreed.

The United States and all other countries have, of course, recognized that gold remains an important asset which countries will want to use even as it is being phased out of the system. The principal motive for including gold in the EC arrangements seems to be the recognition that gold holdings are in fact not readily usable for official purposes. Thus, the arrangements are an attempt to reliquify them to at least a modest extent. We are confident that the EC will continue to consult closely with the IMF as its arrangements evolve to assure consistency with the agreed international objectives concerning liquidity and gold itself.

Conclusion

In conclusion, I draw three important lessons regarding the role of gold from events of the past year.

- First, gold is clearly too volatile an asset to serve as the basis for a stable national or international monetary system. Retention of gold in official stocks provides no assurance of better economic performance. In fact, any attempt to have economic policies influenced by changes in gold holdings would exacerbate current economic problems.
- Second, the future of gold clearly lies in the direction of greater private rather than official use. The private sector is better suited to accept the inherent risk associated with gold holdings.
- Third, the sale of a portion of the huge U.S. stocks can make a useful supplementary contribution to achieving our economic objectives. However, such sales are no substitute to dealing with the economic fundamentals. The administration must and will pursue the economic policies, particularly monetary and fiscal restraint, required to bring inflation down and strengthen the dollar at home and abroad.

Exhibit 63.—Communique of the Interim Committee of the Board of Governors of the International Monetary Fund on the International Monetary System, March 7, 1979, issued after its 12th meeting in Washington, D.C.

1. The Interim Committee of the Board of Governors of the International Monetary Fund held its twelfth meeting in Washington, D.C. on March 7, 1979, under the chairmanship of Mr. Denis Healey, Chancellor of the Exchequer of the United Kingdom. Mr. J. de Larosiere, Managing Director of the International Monetary Fund, participated in the meeting. The Committee welcomed Mr. Abdul Aziz Al-Quraishi, Governor of the Saudi Arabian Monetary Agency, Alternate for Mr. Mohammed Abal-Khail, Minister of Finance and National Economy of Saudi Arabia, on the occasion of the addition of a Saudi Arabian member to the Interim Committee.

The following observers attended during the Committee's discussions: Mr. Gamani Corea, Secretary-General, UNCTAD; Mr. Jean Ripert, Under-Secretary-General for International, Economic and Social Affairs, UN; Mr. Pierre Languetin, General Manager, National Bank of Switzerland; Mr. Rene Larre, General Manager, BIS; Mr. Emile van Lennep, Secretary-General, OECD; Mr. Olivier Long, Director General, GATT; Mr. Ugo Mosca, Director General for Economic and Financial Affairs, CEC; Mr. Rene G. Ortiz, Secretary General, OPEC; Mr. Ernest Stern, Vice President, Operational Staff, IBRD; and Mr. Cesar E. A. Virata, Chairman, Development Committee.

2. The Committee discussed the world economic outlook and the working of the international adjustment process.

The Committee found that the international economic picture remains unsatisfactory in some important respects, but looked forward to an improved payments situation among the industrial countries in 1979.

The Committee noted that although in some industrial countries growth of output had picked up, in most of them it continued at rates that were inadequate to reduce the prevailing high levels of unemployment and to stimulate stronger investment. Indeed,

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medium-term prospects for economic growth in the industrial countries were somewhat less favorable than they appeared at the time of the Committee's previous meeting last September. In this environment, the volume of world trade was expanding at a slow pace and pressures for protectionist trade measures were spreading. It is hoped that the impending conclusion of the Multilateral Trade Negotiations in Geneva will help to reverse the trend toward protectionism.

The Committee was particularly concerned that rates of price increase remained much too high in many of the industrial countries. In some of them, particularly in Europe, inflationary tendencies would seem to require more moderate growth of money incomes. Indeed, the problem of inflation appeared to have become even more difficult over the past several months. This situation required stronger efforts to combat the persistent strength of price and cost pressures, since in many countries further progress in reducing inflation was an essential precondition for the resumption of vigorous economic growth.

A source of special concern to the Committee was the fact that many nonindustrial, or primary producing, countries continue to suffer from subnormal growth rates and high inflation rates. Although some of the primary producing countries have taken successful adjustment action, the general picture for that group, in the Committee's view, is far from satisfactory. The Committee noted with concern the renewed rise in the balance of payments deficits on current account of most developing countries.

The Committee noted the prospect of a better distribution of current account balances among the major industrial countries in 1979 than in 1978—an improvement that would result from the effects of past exchange rate changes and of welcome shifts in growth rates of domestic demand, especially in the United States, the Federal Republic of Germany, and Japan. Realization and maintenance of this improvement, the Committee emphasized, would depend on the pursuit of appropriate national economic policies. The Committee believed that reduced payments imbalances would facilitate the attainment of greater exchange market stability and it noted the improvement achieved in this respect over recent months, following the important policy measures announced by the U.S. authorities on November 1, 1978.

Concern was expressed about the potentially unfavorable impact on many member countries of the recent emergence of uncertainties relating to the supply and price of oil. The Committee welcomed recent moves towards greater conservation of energy.

The Committee believed that the current situation called for maximum coordinated efforts on the part of member countries to follow appropriate policies to deal with problems of economic growth, inflation, and the balance of payments. The strategy envisaged was one geared to the existing diversity of economic positions among countries, to be implemented by economic measures tailored to their particular circumstances.

The Committee considered it especially important that economic policies of the industrial countries take account of the economic needs of the developing countries. Apart from the major contribution on this score that could be made through successful implementation of a coordinated medium-term strategy for growth and balance of payments adjustment, the Committee urged the industrial countries to make every effort to improve market access for the exports of developing countries and to expand the flow of official development assistance.

3. The Committee emphasized the importance of a high degree of international economic cooperation and, with this objective in mind, stressed the necessity of active surveillance by the Fund over the exchange rate and related policies of all members as a means of strengthening the adjustment process.

4. The Committee welcomed the recent entry into effect of the Supplementary Financing Facility, which will enhance the Fund's ability to assist members facing serious payments imbalances that are large in relation to their quotas. The Committee reiterated its view that the Executive Board should consider the question of a subsidy account that would make it possible to alleviate the burden of the charges on low-income members of the Fund using the Facility.

5. The Committee also welcomed the decisions taken by the Executive Board under which SDRs can be used for making loans, settling obligations directly, and in providing security in the form of pledges and transfers subject to retransfer, and endorsed the intention of the Executive Board to pursue and complete, as soon as

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possible, its work on other types of operations involving uses of SDRs, in particular the use of SDRs in swaps, forward operations in SDRs, and donations of SDRs. The Committee also endorsed the intention of the Executive Board to consider increasing the number of official institutions that might, as other holders, be authorized to acquire, hold, and use SDRs.

6. The Committee considered a report by the Executive Board on an Account, to be administered by the Fund, that would accept deposits of foreign exchange from members of the Fund on a voluntary basis in exchange for an equivalent amount of SDR-denominated claims. The purpose of such an Account would be to take a further step toward making the SDR the principal reserve asset in the international monetary system. There was broad support in the Committee for active consideration in the Executive Board of such an Account, and the Executive Board has been asked to present its conclusions to the next meeting of the Committee.

7. The Committee agreed to hold its next meeting in Belgrade, Yugoslavia, on Monday, October 1, 1979, on the occasion of the next Annual Meeting of the Board of Governors. The Committee accepted with pleasure the invitation of the German Government to hold a meeting in Germany in the spring of 1980.

Exhibit 64.—Remarks by Under Secretary for Monetary Affairs Solomon, March 29, 1979, before the Foreign Exchange Association of North America, New York, N.Y., regarding recent developments in the foreign exchange markets

I am pleased to have the opportunity—and the challenge—of reviewing recent developments in the foreign exchange markets with the men and women who represent the professional trading community in the United States. The exchange markets have enormous importance for the international financial system and for the world economy at large. From a practical perspective, they serve as a catalyst for the expansion of international trade and investment, which is essential for raising living standards here and abroad. But in addition, the exchange markets play a special economic role. They form the arena in which exchange rates are determined. Out of that process flow critical price signals influencing what is produced, where it is produced, and where it is sold. It is for these reasons that exchange market stability is of such utmost importance. Only when conditions are orderly can the markets effectively perform their basic function, that of generating a pattern of exchange rates which is consistent with fundamental economic trends and at the same time helps shape international adjustment.

As professionals, however, you know full well that on a daily basis there are many more influences on the exchange markets than just the fundamentals. Rightly or wrongly, any piece of news—economic, political, social—can affect people's expectations about where an exchange rate may go next. That means virtually anything can set off buying or selling of a currency, and on occasion in very large amounts. But traders don't have the luxury of disengaging from the market simply because they personally feel that the trading factor of the moment is unimportant or transitory. They must serve their customers and make markets. And they must perform their responsibilities without exposing their banks to undue risks. So while we all might hope otherwise, the internal dynamics of the exchange markets cannot always be relied upon to produce stability. In times of great uncertainty, the markets may need firm support from the authorities.

Last fall was a time when uncertainties ran unusually deep. The dollar had moved a long way against most other major currencies. Yet selling persisted and in fact broadened, despite frequent official intervention by the U.S. and other authorities. To many thoughtful market participants, there was a sense of unreality to it all. But there was little confidence that the sequence of sharp declines in the dollar almost every day would be halted or reversed by the market itself. And few were bold enough to be the first to try.

To those of us responsible for the international financial policy of the United States, the situation became intolerable. In our view, exchange rate movements for the dollar had clearly gone beyond what could be justified by fundamental economic trends. The consequences were serious. Excessive exchange rate movements threatened to make it

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more difficult to bring inflation under control by subjecting our economy to new upward pressures on prices.

Faced with that grim scenario, we sought to design a response to accomplish two objectives. The basic aim was to lay the foundation for a gradual improvement in confidence that could take hold more firmly as fundamental adjustments in the world and our national economy proceeded. But the immediate objective was to jolt market psychology out of the extreme bearishness that seemed to have taken over. That meant dealing with the market's concerns explicitly and convincingly.

The market's concerns had coalesced around three central themes. First was the problem of the U.S. inflation rate, which had increased during 1978, while inflation in other major countries had declined. What were the prospects for slowing and then reversing our performance, which was a source of dismay to all? Second was the problem of large current account imbalances—here and abroad. Would those imbalances narrow enough and would improvement be sustained? Third was perhaps a more intangible but nevertheless deep-seated concern about the coherence of U.S. economic policy. Would there be a determined, comprehensive, and effective approach to the difficult choices we faced, choices imposed by domestic inflation, external imbalances, energy needs, and foreign exchange market disorder?

We recognized the validity of these concerns and appreciated their importance. Even so, the intensity of the pessimism manifested in the exchange markets seemed to us exaggerated.

First, on the inflation problem: The President had stated unequivocally that arresting inflation in the United States was our major economic objective. A series of steps covering a wide range of policies to achieve that goal had been initiated. A gradual move to monetary restraint was underway. Fiscal policy actions were being planned to reinforce this restraint. Governmental sources of inflation were being attacked. Stricter wage-price standards were set down. In short, we had committed ourselves to deal with inflation and that commitment was being systematically implemented—not in one grand, comprehensive package, but by individual actions taken as rapidly as possible. We recognized that results would not come overnight, and there would be setbacks along the way. There was full recognition that a moderation of economic growth, which was clearly advisable, and public support for the anti-inflation initiative together would strengthen the chances for success.

Second, on the balance of payments problem: Our current account deficit had peaked by early 1978. In subsequent months, the wide divergences between U.S. and foreign economic growth had started to narrow, and previous exchange rate movements were reinforcing the balance of payments impact of that narrowing. As a result, the U.S. current account deficit was declining significantly and there was progress toward reducing some of the major surpluses abroad. As it turned out, by the second half of 1978 the U.S. deficit was less than half what it had been the year before, and every indication was pointing toward further improvement.

To be sure, increases in oil prices will offset a part of the full improvement that would otherwise have occurred. How much, we don't know, because OPEC has essentially given producing countries a license to charge what the traffic will bear. Some will probably do just that. Others may take a longer view of the impact of oil prices on the world. But as you know, the United States is committed, along with other countries participating in the International Energy Agency, to a 5-percent reduction in oil consumption this year. Conservation efforts are essential, and as they take hold, petroleum imports should slacken. If we and other major consumers succeed in these conservation efforts, the surcharges which some OPEC countries hope to collect may not hold.

In any case, the oil situation is one factor that complicates the balance of payments outlook. Decisions of the new Iranian Government to curtail military purchases are another. But U.S. exports of goods and services continue to grow strongly, and there are signs that the public is grasping the pressing need to save energy. Going through the exercise of estimating the net effect of these various influences is more difficult than usual, and I think it is premature to cite any particular forecast today. But based on preliminary findings, we still anticipate a substantial reduction in our current account deficit this year. At the same time, we expect further adjustment abroad by

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countries in surplus as economic growth there is maintained and in some cases expanded.

Third, on the problem of policy coherence: It is imperative for government to pursue appropriate policies. But sometimes that is not enough. There must also be an unmistakable signal of commitment. In the circumstances confronting us last October—extreme disorder in the exchange markets and worsening inflation in domestic markets—decisive action on many fronts was needed to dramatize a new thrust to policy. On the monetary side, the Federal Reserve acted forcefully to stiffen the degree of restraint. The discount rate was increased by a full percent and reserve requirements were raised. Those actions were important. They helped lay a firm domestic basis from which to launch a major attack against foreign exchange market disorder. To implement it, we mobilized a very large amount of resources, using a variety of financing techniques, new and old, and working in close cooperation with the Germans, Japanese, and Swiss authorities. We wanted to leave no doubt that we were fully prepared to back up our commitment to restore stability to the markets. You know the details of the November 1 financing package and how we proceeded to use it—whenever and on whatever scale necessary to dispel any residue of skepticism about our intentions.

The results so far have been gratifying. By any standard, market conditions have been better since November 1 than before. That is not primarily because of a stream of what might be called good news. I'd say the recent news has been mixed. Some of the numbers have been disturbing—such as the latest wholesale and consumer price statistics. I draw little comfort from the fact that faster price rises have been recorded abroad as well as in the United States. However, other numbers have been reassuring—for instance, the continued deceleration in the growth of the money supply in reaction to the Fed's policy of restraint. Moreover, while I avoid placing too much emphasis on one month's figures, the trade statistics for February announced yesterday do tend to reconfirm the improving trend that began last year. Still other events, inherently complex and with implications not only for the United States but for all countries, have had diverse effects on the exchange markets. The Iranian situation is a good illustration of that kind of complex development, and so is the oil supply and price situation more generally. All countries are affected, but in different ways, and the differential impact is hard to determine with any degree of certainty. I think most participants in the exchange markets appreciate that point and have responded accordingly.

What I conclude, and take some satisfaction from, is that the underlying tone in the exchange markets has vastly improved. By itself, this has promoted a more judicious assessment by market participants of new trading factors as they come along. No longer is there a knee-jerk reaction to sell the dollar on most every item carried over the wire services. Certainly, dollar exchange rates have showed some daily variation. That is to be expected in a normal, orderly market. But rate movements are not cumulating. There is a counterweight, stemming from the market itself but occasionally reinforced by operations of the authorities, tending to restore balance. As a result, the average daily movement in most major currencies is just a fraction of what it was last October. In recent weeks, the only currency that has fluctuated fairly sharply has been the Japanese yen. In large part, that reflects shifting market perceptions of Japan's relative vulnerability to the oil situation. But I think that a firm official response is helping to reduce the erratic movements in the yen market.

There are other concrete signs of an improvement in exchange market conditions. Some of last year's leads and lags in commercial payments have been unwound. The pace of diversification has slowed noticeably and may even have been reversed in some cases. Borrowing of dollars to finance exchange positions has diminished. Investors are responding to relative interest rate incentives and are acquiring dollar assets. And perhaps most concretely, we have substantially improved our own net position in foreign currencies. Factoring in the proceeds of our foreign currency note issues and other acquisitions of currency, the United States now has more resources immediately available for current operations than we did just after November 1.

Looking to the future, I don't pretend to know with any precision how the markets will develop. From what I hear in the Street, opinions naturally differ about the possible course of rate movements over the rest of the year. But I am intrigued as

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much by the flavor of the comments as by the predictions themselves. Expectations do not seem to be held with any great conviction, perhaps because the past few months have been a chastening experience for a number of people. I'm encouraged by this greater sense of two-way risk in the market. It helps keep market conditions more orderly. Consequently, unless there is some major shock to the world economy, I would foresee a continuation of the generally balanced trading conditions we have now.

Whatever your own personal views on the outlook, I want you to bear in mind these final thoughts. We remain committed to the underlying principles embodied in the measures taken last fall. We will not hesitate to use our ample resources to meet our objectives. And above all, we will continue to pursue a coordinated policy of restraint to ensure that progress is made in curbing inflation, lowering payments imbalances, and achieving more moderate but sustainable growth in our economy. Surely, those are the essential ingredients for a strong and stable dollar over the long haul.

Exhibit 65.—Remarks of Under Secretary for Monetary Affairs Solomon, May 11, 1979, before the National Journal International Trade and Investment Conference, Washington, D.C., on the international monetary system and its impact on future international trade and investment

You have asked: "Will the current international monetary system serve the future international trade and investment environment?"

My answer is—in the short run—"yes," fundamental changes have been introduced in recent years which give us more workable monetary and credit arrangements. But in the longer run, the present system will not necessarily meet future needs. The international monetary system is undergoing, and must undergo, continuous evolution to adapt to changing conditions. Several important—and related—lines of evolution are now under consideration, responding to concerns about the current system. I would mention three such concerns:

First is a cluster of concerns about the operations of the international banking and credit system, and particularly the Eurocurrency market. Does it provide adequate credit, or too much? Is it aiding international adjustment, or retarding it? Is the market adequately supervised, or is there a risk of imprudent banking practices?

Second is a concern that the large stock of dollars in foreign hands, private and official, is destabilizing, and that the international role of the dollar should be reduced in the future in order to achieve greater stability in the international monetary system.

Third, and in my judgment most important, is a concern that our arrangements for international coordination of economic policy may not keep up with the demands of an increasingly interdependent world.

International banking

The marked expansion of the Eurocurrency market in recent years is often viewed with awe and apprehension. Some favor greater official action to bring the market under tighter control. In fact, the degree of official attention given this market in recent years, and the degree of supervision and regulation that actually exists, are much greater than generally realized. Whether or not there is a case for further measures, we should understand the major shifts that have occurred in the world's needs for financing, and what the role of the Eurocurrency market has been.

In the early 1960's, payments imbalances among nations were relatively small, with the developed countries as a group running modest current account surpluses, transferring net real resources to the developing countries, whose deficits were largely financed by grants and loans of official development assistance, or by private direct investment.

In the latter half of the 1960's, the U.S. balance of payments came under strain, because of reduced current account surpluses and large capital outflows. In part, these capital outflows took the form of direct investment—as American firms sought to maintain markets abroad by producing there. Also, foreign governments and their citizens borrowed more in our markets, to expand consumption and investment.

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Eventually, to maintain the dollar's par value and the system of gold convertibility, the United States imposed capital controls to deter lending by U.S. residents and to encourage American firms to borrow abroad, thus reducing the net capital outflow and resulting pressure on the dollar.

These controls gave a tremendous boost to the development of offshore money markets—the use of dollars by nonresidents for meeting the rising world demand for credit. Other national markets were either too thin and undeveloped or, like those in the United Kingdom, imprisoned by controls. The international financial market that emerged—the Eurocurrency market—became so efficient that even when the U.S. controls were removed, it could compete effectively both in bidding for deposits and in extending loans. Rather than withering away, it flourished.

In part, the comparative advantages of the Euromarket are attributable to clear financial incentives. There are no reserve requirements, no interest rate ceilings, and no credit controls. In some cases, tax considerations favor doing business in the Euromarket rather than domestic markets. But other factors are equally important in explaining the market's attraction and vigor: It has proven extraordinarily innovative in developing new financial instruments to meet its customers' needs; it has provided a focal point for intense competition among the leading banks from each of a number of national banking systems; and it has offered insulation from various political risks, or at least an opportunity to diversify those risks internationally.

The growth of the market has given rise to a persistent debate: whether it is an engine of excessive credit creation which aggravates world inflation, or essentially a highly efficient intermediary reallocating funds from lenders to borrowers. Certainly, a large part of new international lending has been channeled through the Euromarket because of its attractions. Despite its growth, Euromarket credit to final borrowers is still only a fraction of total funds raised in domestic banking markets—in the case of dollar credit, on the order of 15 percent over the 1974–78 period. But it is a growing fraction, and its relation to domestic and international money and credit flows needs to be carefully assessed.

The growth of international banking activity has been due not solely or mainly to the existence of the Euromarket but to vastly increased international credit needs. In recent years, and particularly since the oil price quadrupled in 1974, the size of the aggregate current account imbalances which the system must finance has risen dramatically. Aggregate current account deficits rose from an annual average of $15 billion in 1971–73 to an average during 1974–78 of $80 billion annually—a total of $400 billion in 5 years.

Countries facing these sharply higher deficits needed credit on an unprecedented scale. Without such credit, they would have been forced to reduce their external deficits by imposing extremely severe restrictions on domestic demand, or resorting to aggressive trade and exchange rate behavior. Until last year, the OPEC surplus countries provided most of that credit, and the international banking system served as the intermediary.

Some contend that the Euromarket went too far—that it made credit too readily available and thus fostered excess liquidity, excess demand and inflation. However, the role of the Euromarket has been essentially that of an intermediary and to a considerable extent borrowers and depositors would have moved to national markets in the absence of the Euromarket. Moreover, there was a genuine need for this credit, and I do not believe that the world economy would have been better served had the volume of credit been substantially less. Even with the amount of credit that was in fact available, the world experienced its worst recession in decades, and recovery, for many nations, has been agonizingly slow.

Some individual countries have, of course, faced difficulty servicing their increased external debts. Some neared the limits of their capacity to borrow very quickly and were then compelled to step on the brakes too hard. This poses difficult problems for the countries and lenders concerned, and such experiences will undoubtedly have a moderating influence on both borrowers and lenders in the future. But it is not clear that *general* controls on the Eurocurrency market, even if effective in reducing global credit expansion significantly, would be an appropriate response to what in practice has been a very *selective* and specific problem.

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In the past year or so the pattern of international financing has changed, with the shift of the United Kingdom, Italy, and France into current account surplus; the reduction of the U.S. current account deficit; the decline in Japan's surplus; and the dramatic decline in the OPEC surplus to less than $5 billion in 1978 as a whole and near zero in the second half of the year.

Unfortunately, the near-elimination of the OPEC surplus last year was short lived. The recent oil price decisions, and reduced growth in OPEC import demand, are producing a new and sharp increase in the surplus. Assuming that the international credit mechanism continues to function, and that oil-importing countries are not forced to curtail domestic demand dramatically, the OPEC surplus will rise to $25-$30 billion in 1979 and more in 1980—much more if there are further significant increases in the price of oil. Even if the Japanese surplus continues to decline substantially and there is some reduction in the surpluses of other countries such as Germany and Switzerland, world current account deficits are likely to total something on the order of $80 billion in 1979 and possibly more in 1980, very large deficits indeed.

We must anticipate continued growth of international credit—growth on a vary large scale—until these large current account imbalances can be reduced. Official financing must be adequate to meet critical needs but will not—and should not—meet the bulk of the financing need. That will be provided by the private markets. The private markets will have to account for perhaps three-fourths of the total financing needs, on the basis of the past trends. Thus we must expect the size of these markets to continue to expand.

The economic problem is to allocate funds from surplus to deficit countries. But in the process we must be sure that these flows do not overburden the financial institutions or threaten the banking system generally. The prospect of continuing growth makes it all the more important that national authorities have adequate information and exercise adequate control and surveillance over the operations of banks in the market.

In recent years, the U.S. banking authorities—the Comptroller of the Currency, the Federal Reserve, and the FDIC—have taken a number of steps to improve the supervision of foreign lending by U.S. banks, including the operations of their branches in the Euromarket. The new approach is designed to promote appropriate diversification of bank portfolios and to avoid excessive concentration of lending relative to a bank's capital position. Special attention is given to bank management procedures for assessing risk and controlling exposure. To support these efforts, new, comprehensive reports are being collected from each U.S. bank doing business internationally. The information provided shows a bank's exposure to each country abroad, with detailed breakdowns by type of customer, type of loan, and maturity. The reporting system gives bank examiners a uniform basis for reviewing in detail a bank's internal loan and deposit records. The approach is complemented by onsight inspection at U.S. banks' overseas branches. Above all, the supervisory system emphasizes the continuing need for banks to take account of changes in economic conditions in countries abroad in formulating their lending policies. To be sure, no supervisory approach can guarantee that there will never be a problem with a particular loan. But the emphasis on strong management controls and adequate diversification should limit potential adverse effects on the banking system as a whole.

The need for improved supervision has been recognized by a number of countries, and many have felt that a cooperative international approach could reinforce their own domestic efforts. There has been a significant expansion in the amount of information collected through the Bank for International Settlements, and new efforts are underway. The central banks of all major countries meet regularly through the BIS, at the policy level and the technical level, to exchange views on Euromarket developments and to discuss supervisory techniques. These efforts are being strengthened.

Nonetheless, we recognize that the Euromarket represents a global system, and that the participants in that market manage their positions from a global perspective. These markets inevitably interact with domestic money and credit markets. Therefore, we should consider whether additional measures are needed to help assure that the Euromarkets do not work to erode domestic money and credit policies, and that the markets themselves remain strong and capable of fulfilling their intermediary function.

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A variety of instruments—for example, introduction of a minimum reserve requirement on Eurocurrency deposits—could be considered that would make a contribution to the strength and stability of the Euromarket, and to the greater effectiveness of national and international monetary policies. This is an area that deserves careful attention in the period ahead. In the meantime, the United States will continue to work to assure that there is adequate information about the Eurocurrency markets and supervision necessary to insure that the markets operate prudently.

International role of the dollar

The second area of concern, the international role of the dollar, is related very closely to the concern about international credit. The bulk of Euromarket activity, and the bulk of private and official borrowing, lending, and reserve accumulation, takes the form of dollars. As these magnitudes have grown by scale factors in recent years, so also has the volume of dollars held by non-U.S. residents, whether in the form of claims on the United States or dollar claims on the Euromarket.

The concern is whether the existence of large dollar balances constitutes an important source of instability in the international monetary system. Particularly in the light of the exchange market instability of recent years and the heightened perception that external developments do make a difference to the United States, this concern has given rise to various proposals—for funding or consolidating foreign official dollar holdings, for increasing the role of the SDR in the system, and for placing greater reliance on other currencies, such as the Deutsche mark and the Japanese yen, in international financial transactions and reserves.

It is clear that sudden shifts in ownership of dollar balances can and sometimes do add importantly to pressures and instability in the exchange markets. But there is substantial question whether the existence of large foreign-held balances is the major part of the problem that has affected the dollar. The period of dollar instability prior to last November 1 undoubtedly was rooted in questions about our underlying economic policies, performance, and outlook; questions about our will in mounting a coherent and effective attack on problems of energy and inflation. There was during that period some diversification by foreigners out of dollar holdings—mainly private but to some extent official. But that experience also reaffirmed what we already knew—that there is enormous scope for capital movements and changes in the timing of payments by American residents, leading to exchange market pressures quite independent of an existing stock of foreign dollar balances. The experience since November 1—involving large reflows into dollars—has taught that same lesson in reverse. Thus while moves to reduce the international role of the dollar, particularly the reserve role, may have some positive impact on market perceptions and behavior, I do not believe this approach can get at the root cause of exchange market problems.

Consequently, the effort to strengthen the role of the SDR—and as part of that effort, discussion of a possible substitution account in the IMF—should be seen as part of a long-term evolution of the system, an evolution which holds out an ultimate prospect of greater order and stability, but which is not directed to the immediate market situation.

I should stress that in this examination of structural changes in the international monetary system, the U.S. objective is not to perpetuate a particular international role for the dollar. The dollar's present role is itself the product of an evolutionary process—a process that will continue, and that may bring a reduction in the dollar's relative role in the future. Indeed, some of the main factors in the evolution of the dollar's role would appear to suggest some gradual reduction.

First, the relative size of the U.S. economy has declined substantially over the past two decades, from about 30 percent of the world's GNP in 1960 to about 23 percent in 1978. I would expect the trend to continue to some extent during the 1980's, as developing nations continue to grow faster than the world's average, and the spread of technology enables other nations to move closer to the high levels of production and living standards enjoyed by the United States.

Second, foreign capital markets have also expanded relative to that of the United States. In 1964, the U.S. capital market provided roughly $80 billion of net new credit, as compared with less than half that amount in Japan and Germany combined. By

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1977, the figures had grown to about $400 billion in the United States, as compared with about $250 billion in Japan and Germany. During the 1960's, no market other than the United States could have handled issues of the size needed by major international borrowers, some of which exceeded $100 million. That is no longer the case. As an example, the U.S. Treasury raised almost $3 billion on the German market in a 3-month period following the November 1 announcement.

But against these developments, the openness of the U.S. market is not duplicated in other major countries. Most maintain restrictions of one kind or another, applied with varying degrees of severity.

Thus, while there have been significant changes in the relative size of the U.S. economy and capital market, these have not been paralleled fully by opening of foreign money and capital markets. Yet it seems to me that this last condition must be fulfilled if there is to be a significant reduction in the dollar's international role. The SDR offers potential for assuming a larger role in official reserves—and perhaps, in time, a role in private transactions. But given the large volume of international credit that will be needed in coming years, a reduction in the role of the dollar in practical terms implies willingness of other countries to open their money and capital markets, to match their heavier weight in the international economic system. Some progress has been and is being made. More is needed.

Economic policy coordination

The third major area of concern—in my view, the most fundamental and most important one—is whether and how quickly the international community can bring itself to coordinate economic policies more effectively, to reduce inflation rates and inflation differentials, and to manage domestic growth rates so as to bring about a better balance in global economic relations.

I do not believe that the instabilities and tensions of recent years can realistically be ascribed in an important way to defects in our international monetary arrangements per se. They are more deeply rooted in the massive move toward interdependence that has characterized the past three decades. Progressive trade liberalization and heightened access to international capital brought unparalleled progress to the world economy. But as part of this process, national economies became much more intertwined. The industrial and agricultural structures of the advanced nations are now highly dependent on foreign sources and foreign outlets. Trade flows, now greatly liberalized, respond more quickly and more powerfully to changes in incentives. Owners of capital have become much more sensitive to opportunities to move money across national boundaries and freer to do so. Exchange rates, and the international monetary system more generally, have become subject to much more immediate responses to disparities that develop in national economic performance.

In short, the benefits of greater interdependence have come at the price of greater exposure and vulnerability to events elsewhere in the world. One practical implication of greater interdependence is greater constraint on national policy formulation. Today all governments are constrained to take account of the effects of their policies on others; to factor external developments into domestic policy formulation; and to maintain consistency between their international economic objectives and their domestic economic performance.

Such constraints have never been entirely absent. But with the changes we have witnessed in the world economic structure over the past three decades, they have become more severe and more difficult to ignore. There is broad international understanding of the meaning and implications of interdependence, not only on an intellectual level but to some extent in practice. We have over the years developed a variety of organtzations to facilitate international cooperation in many fields. The OECD has served as a forum for discussion among the industrial countries of economic policies and balance of payments developments. The IMF has traditionally consulted with member countries on broad economic policies, and has been given important new potential for expression of policy advice. The economic summits have opened a new range of possibilities for coordination at the highest level among the largest countries.

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But we are still trying to work out the right organizational framework for international coordination of national economic policy—and to make such coordination meaningful in translating international consensus into domestic action.

We all face the imperative of cooperating and coordinating to deal with the pressures of interdependence. The key question is whether we can deal with these pressures in a constructive and mutually beneficial way—whether our ability to manage meaningful domestic policy coordination on the part of sovereign governments will keep up with the strains arising from our increased interdependence. Evolution of the IMF's surveillance role will provide a test. The IMF has been given potentially important powers of surveillance and advice not only over member countries' exchange arrangements, but over their domestic economic policies as those policies relate to the international adjustment process. These provisions afford a framework that can be developed to provide a practical vehicle for policy coordination—if governments are prepared to give the Fund the necessary power and influence.

Conclusion

I began this talk by referring to the question posed by the organizers of this conference: Whether the current international monetary system will serve the future international trade and investment environment. I believe that our international financial and monetary arrangements should and will evolve, and our effort will be to see that they evolve in a direction that is compatible with and supportive of a liberal world trade and investment system. The current period of relative monetary stability provides both a basis for confidence and breathing space for unhurried consideration of ways to strengthen our monetary arrangements. But the key question goes well beyond improvements in our monetary arrangements—it is the need for governments to improve international economic policy coordination, in recognition of their self-interest in preserving our interdependent system. Meeting that need is central to the maintenance of an open and liberal trade and investment environment for the future, and it must be the focal point of our efforts.

Exhibit 66.—Remarks by Assistant Secretary Bergsten, June 5, 1979, before the International Management and Development Institute, Washington, D.C., entitled "The Underlying Strength in the U.S. Balance of Payments"

The strength of the dollar

A major element of the international financial scene during the past 7 months has been the strength of the dollar. Since November 1, the dollar has appreciated by about 13½ percent in terms of other OECD currencies—25 percent against the yen, 17 percent against the Swiss franc, and 10½ percent against the German mark alone—despite sizable intervention by several countries and a considerable amount of bad news. In short, the strength of the dollar has been quite impressive.

This renewed strength comes from a variety of sources. Because of the firm actions taken last November 1 by the President, markets have reflected confidence in the administration's commitment to reducing U.S. inflation and to reducing our external imbalance. This confidence has produced a sharp reversal in capital flows—net banking inflows in the first quarter of $13.5 billion virtually matched the large outflow of the fourth quarter. Leads and lags on trade payments have also been reversed. The markets seem to perceive the increasing difficulties in the world oil market as further strengthening the dollar.

The improvement in the U.S. current account

Perhaps most important, however, is the substantial reduction in the U.S. current account deficit. In the fourth quarter of 1977 and the first quarter of 1978, the U.S. current account deficit averaged $6.9 billion. This rate was halved in the second and third quarters of 1978, to an average of $3.5 billion. In the fourth quarter of 1978 and

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the first quarter of 1979, the deficit fell by half again to something like an average of \$1.7 billion.

It is not only the U.S. current account which has been recording dramatic adjustment. There has been like progress, in the opposite direction, in reducing the major surplus in the world economy—that of Japan.

Indeed, there has been some parallel between movements in the U.S. and Japanese balances. In 1978, we ran a current account deficit of \$16 billion and Japan ran a current account surplus of \$16 billion. Over the last 12 months, the Japanese surplus fell from an average of \$4.4 billion in mid-1978 to an average of \$1.3 billion in the fourth quarter of 1978 and first quarter of 1979. For the first 4 months of 1979, the Japanese current account was actually in deficit.

Both swings—the declines in the Japanese surplus and U.S. deficit—result from exchange rate movements and changes in relative growth rates. Japan's commitment to strong domestic demand growth, at last year's Bonn summit, produced a sharp pickup in 1978 which clearly raised Japanese imports and reduced the impetus to Japanese firms to sell abroad. The expected, and welcome, slowdown in the U.S. economy made a parallel contribution from our side. In addition, relative price movements adjusted for exchange rate changes were important factors in the shift in current account positions, as Japan's competitive position between the beginning of 1977 and mid-1978 deteriorated by 10 to 15 percent while the U.S. position strengthened by 3 to 5 percent.

The export performance of both countries reflected these changed conditions. Japanese export volume declined by 4 percent during 1978, while U.S. export volume rose an impressive 17 percent during the same period. I do not believe that these trends will continue at such rates, but they do represent substantial shifts in levels of export volumes which should be substantially sustained.

The strong U.S. export growth was widely spread geographically. During the first quarter of this year, our trade balance with the non-OPEC world was in surplus for the first time since early 1977, when our trade balance began its sharp deterioration. In the first quarter of 1978, the U.S. trade deficit was at an annual rate of \$23 billion with non-OPEC areas. During the first quarter of this year, that balance had swung into an annual rate surplus of about \$1 billion. Of the \$24 billion improvement, the vast majority came against developed countries—some \$19 billion. The European Economic Community accounted for almost \$10 billion of the gains, and trade with Japan about \$5 billion.

The sharp rise in U.S. export competitiveness can also be seen in market share data. A Department of Commerce calculation shows that the U.S. share of world exports of manufactured goods increased for the second straight quarter in the third quarter of 1978, the first time since 1974 that the U.S. share had gained in two consecutive periods. It is highly likely that the last two quarters will add to that string, since the volume of U.S. exports on nonagricultural products rose by 22 percent from the first quarter of 1978 to the first quarter of 1979—far exceeding the overall growth of world trade in manufactures. At the same time, the volume of U.S. nonoil imports rose by only about 1 percent. Our nonagricultural, nonoil balance—probably the best measure of basic U.S. competitiveness in world trade—improved at an annual rate of \$22 billion over the past year.

The market share calculations just cited are made on the basis of export value; thus the gain occurred while the dollar was depreciating, and is thus even more impressive in real terms. Another approach to competitiveness centers on volume shares, which is theoretically more appealing but practically more elusive due to statistical problems with unit value indices.

Our best volume calculations do, however, confirm the above results. In real terms, the U.S. share of world exports of manufactures is now at its highest level in 3 years. It stands higher today than in either 1971 or 1972, and only 1 percentage point below the recent peak reached in 1975. Our largest gains in real export shares came in the less developed countries, especially Latin America. I suspect that the increased growth of Mexico and Brazil—traditionally very important U.S. markets—account for a substantial portion of this increase.

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The effect of higher oil prices

Thus there is a good deal of good news concerning U.S. competitiveness in world trade. Before excessive euphoria sets in, however, let me be quick to point to the large trade deficit with OPEC. The U.S. deficit with OPEC has increased from an annual rate of $15 billion in the first quarter of 1978 to roughly $19 billion in the first quarter of this year. We estimate that the United States now imports roughly 9 million barrels of oil a day. At today's prices, the cost of this oil is roughly $55 billion a year—$150 million a day, or about $250 a year for every man, woman, and child in the United States. Five years ago, the same volume of oil would have cost only $11 billion.

Oil now accounts for *one-quarter* of total U.S. imports, as opposed to about 7 percent in 1970. Oil price uncertainty thus complicates the task of projecting the near-term outlook for the U.S. trade balance. Last December, OPEC announced a price schedule for 1979 that would have raised prices an average of 10 percent during 1979. The Iranian situation and its effect on oil production set the stage for another OPEC price rise in April, producing a level of prices which would be about 20 percent higher on average in 1979 than in 1978, and 26 percent higher from the end of 1978 to the end of 1979. Any further increases would of course add to those numbers.

Of course, we feel the effect of OPEC pricing decisions not only directly via increases in our oil import bill but also indirectly via losses of U.S. exports. Sharp oil price increases produce real income losses abroad (as in the United States), which in turn reduce aggregate demand for goods—part of which demand is met by U.S. exports. Hence, U.S. exports generally are lower after an oil price rise than they would have been in its absence.

Forecasting the U.S. current account

Before going into detail on the U.S. outlook, I want to look briefly at the forecasting process. Trade flows are generally projected on the basis of historical relationships between changes in exports and imports, on the one hand, and changes in income and relative prices on the other. In broad terms, the level of U.S. merchandise exports is determined by the level and growth rate of foreign income, and the relative prices of U.S. goods compared to other countries' goods. The faster foreign economies grow and the more competitive U.S. products become, the higher will be our exports.

The econometric equations which underlie most forecasts are complex, but they essentially follow this approach. In particular, the formal equations attempt to estimate lag structures for the response of exports to changes in incomes and prices. They try to answer the question "How many quarters does it take for exports to respond to a change in prices?"

They also try to estimate the shape of the response: e.g., does 50 percent occur in the first year or in the second? Economists hold rather strong differences of view about both the length and shape of the lag structure. There are basically two schools of thought: Short-laggers and long-laggers. The short-lag view holds that most of the effect of price changes is observed in the first year. The long-lag view argues that trade relations shift only slowly; that it takes time to search out new supply sources; and that much trade occurs under long-term (1- to 2-year) supply contracts. The empirical evidence on the lag structure is rather mixed. Both views can find support in data and experience. From a policymaker's point of view, the question of lag structures is important—we want to know whether most of the export gains from the dollar's 1977–78 depreciation are behind us or ahead of us.

Most trade models and equations are fairly good at explaining the historical relationships between the variables. In explaining the past, the equations tend to account for something like 85 to 95 percent of trade movements. But the level of U.S. merchandise exports in 1978 was $142 billion. A forecasting error of 10 percent would have amounted to roughly $14 billion. At the same time, imports in 1978 were $176 billion and a 10-percent error would have been $18 billion. If both errors came at the same time, a trade forecast for 1978 could have been $32 billion off the mark. Since our actual merchandise trade deficit was $34 billion, forecasts of rough balance to a deficit of $60 billion could have resulted from the standard forecasting tools.

The process of forecasting the U.S. trade balance requires us to make forecasts of growth and inflation in the economies of our major trading partners—and of the

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United States as well. Most of you know the problems associated with forecasting U.S. GNP and inflation. But you should also know that U.S. trade forecasts also depend on forecasts of growth and inflation in Canada, Japan, Germany, the United Kingdom, France, Italy, the OPEC countries, and LDC's. Obviously our forecasts of the U.S. trade balance are only as good as our forecasts of developments in major countries and areas abroad, as well as our domestic assumptions.

I mention this to point up the difficulty of precise forecasts, and to note that one has to laugh at the spurious precision of forecasts of trade deficits to half billions of dollars. Total U.S. trade in 1979 is likely to equal about $375 billion, so a 1-percent error would be $3-$4 billion and just a 5-percent error $15-$20 billion!

Then, of course, the trade balance is only part of the current account, which also includes service transactions—military sales, tourism, freight, income payments, et cetera—and private and government transfers. Gross service receipts in 1978 were $76 billion, payments $53 billion—$129 billion of total two-way flow. In 1978 the total gross goods and services flows amounted to roughly $450 billion. Needless to say, very small forecasting errors can dramatically change one's forecast of the balance. We should be modest in the precision with which we forecast trade and current account balances, for the United States or any other country.

The outlook for the U.S. current account

Having said all that, let me proceed to a fairly precise forecast for the U.S. current account in 1979 and early 1980—all on the assumption that oil prices remain about where they are now. This year's current account deficit should be about $5-$6 billion smaller than last year's $16 billion, coming in at around $10-$11 billion. It should continue to strengthen in 1980, to a deficit in the $2-$6 billion range.

The 1979 improvement is expected to derive from—

- A $27-$28 billion gain in nonagricultural exports (excluding gold auction effects), compared with a probable $16 billion increase in nonpetroleum imports and thus an improvement of $11-$12 billion in those parts of our trade position which most accurately reflect the competitive position of the United States in the world economy;
- An additional $2 billion of gold auction effects;
- A $2 billion rise in agricultural exports;
- No change or a slight decline in our surplus on service transactions, which totaled $23 billion last year;
- A further offsetting increase of about $10 billion in our oil import bill.

In volume terms, we expect nonagricultural exports (excluding gold) to grow about 10 percent this year over last, in contrast with an increase of less than 1 percent in nonpetroleum import volume. Average unit values should also increase somewhat faster on the export side (13 percent versus 9 percent). Our services estimates include an allowance of about $3 billion for the virtual ending of military deliveries to Iran, and slower deliveries elsewhere in the Middle East. We also expect that the surplus on net investment income (which grew by about $2.5 billion last year) will not increase this year, due to interest payments on the higher level of U.S. liabilities to foreigners which is the counterpart of our recent current account deficits. Also, the U.S. nonagricultural export projection includes a rounded $1 billion allowance for reduced nonmilitary sales to Iran.

Our estimate of a $52 billion oil import bill for 1979 includes all OPEC price and surcharge increases announced through mid-May. It also envisages a substantial reduction in the volume of U.S. oil imports during the course of this year, from the current rate of about 9 million barrels per day, as supply constraints and conservation measures enable us to meet our IEA commitment to reduce consumption by 5 percent by early next year. However, the current outlook we are presenting for 1979 and next year is vulnerable to any further sharp OPEC price increases.

Conclusion

Some very clear conclusions emerge from this analysis:

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- There has been a dramatic improvement in the U.S. competitive position in world trade, both in export markets and in competing with imports at home.
- Given time, the adjustment process works at least for the United States and Japan; differential growth rates and changes in exchange rates do have big effects.
- The United States must reduce the growth of its oil imports for balance of payments as well as broader reasons.
- Even with success in limiting oil imports, we will have to make a major effort to expand U.S. exports still further.

These conclusions provide us with both a basis for confidence in the ability of the United States to compete in the world economy, and with an agenda for further action concerning energy imports and export expansion. The President has launched major programs in both areas. Their success should assure continued strength and stability for the dollar.

Exhibit 67.—Remarks of Secretary Blumenthal, June 14, 1979, at the Ministerial meeting of OECD, Paris, France

In other circumstances, our appraisal of recent developments and prospects in the world economy would have a positive thrust. Our strategy of concerted macroeconomic policies has made an important contribution to improved economic performance:

- There is today a greater convergence of growth among the major industrial countries.
- Considerable progress has been made in reducing payments imbalances among the larger countries.
- The exchange markets, supported by joint action by our monetary authorities, have become more orderly and better balanced.

But in recent weeks some very nasty storm clouds have appeared. They threaten us with much worse inflation and payments positions, and in time they threaten to stop the growth we need to reduce unemployment.

These clouds have formed out of the reduction in Iranian oil production and the decisions of various oil-producing states to limit the quantity of oil they are prepared to produce. For the immediate future this means that we cannot be confident that the increase in the quantity of oil necessary to sustain continued economic growth will be available.

We calculate that the average OPEC crude oil price is today over $17 per barrel—up 33 percent from the December 1978 average, and almost 25 percent higher than we had anticipated as a result of the Abu Dhabi price action last December. We must recognize that, given continued supply uncertainties and turmoil in markets, and uncertainties covering the pace of conservation in consuming countries, there is considerable danger that we will enter 1980 facing oil import bills that will represent a severe challenge to our ability to stabilize our economies and maintain respectable rates of growth.

The IEA Ministers met on May 21-22 to consider this situation and concluded that "the world energy supply situation will be tight for the foreseeable future" and that "if nothing is done to change present trends, available energy supplies will not be sufficient to support even moderate economic growth." This is not an overstatement.

As this group is well aware, inflationary pressures are already on the upswing. Further sharp increases in oil prices will reduce real incomes and exacerbate inflationary expectations. Real expenditures and growth will slow and unemployment will rise. We can achieve economic growth only to the extent that we can persuade oil producers to raise their level of output, reduce the use of oil per unit of production, or increase our output of some other form of energy. There are no other ways to maintain world growth.

The choice is not between growth and inflation. It is between growth with conservation and low growth with high inflation. But even conservation will only buy

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a little time. It has become unmistakably clear that we must initiate forceful actions to expand production of energy and we must do so now without further delay. In the longer run, there is simply no alternative to the development of major energy sources which will substitute directly for imported oil. Without a drastic energy effort on the part of all major countries, we will achieve neither growth nor price stability.

This is reality. We must face it.

The rises in the price of oil we have already experienced—both in the United States and elsewhere—will tend to increase the rate of inflation. If price increases spread to other commodities, if labor unions seek to offset oil price increases with further wage increases, if either business or consumers are led to expect general increases in the rate of inflation, our entire demand management strategy will be placed in jeopardy.

There is only one way we can ease further upward pressure on oil prices in the short run, and that is to conserve oil—by every means we can that does not cripple our economies. At this point the margin of scarcity is not great; we estimate that it is 1 to 2 million barrels per day. Conservation—if quickly and aggressively pursued—can ease substantially the current pressure on oil prices. The Governing Board of the IEA has called for savings of 2 mbd by the end of this year. It is of great importance to both growth and price stability throughout the world that these savings be achieved.

But next year we will need to do even more. Our objective is a continued increase in total world output—a rate of economic growth which is faster than oil producers appear to be prepared to increase oil output. To realize our growth goals, we will need to achieve further savings in our use of oil.

The United States will do its part. The people of the United States have been most reluctant to allow the price of oil to rise because there is a substantial volume of oil produced in the United States at costs which are already amply covered by prevailing prices. Domestic prices have been controlled for this reason. Nevertheless, beginning this month we will phase out those controls. We will allow the force of market prices to encourage conservation and promote alternative supply.

I strongly endorse the plans of the EPC to review the world economic situation this fall in light of oil market developments, to ascertain whether we—collectively and individually—are being sufficiently successful in our conservation efforts to preserve our strategy for growth.

At the same time, for the medium to long term, the principal answer must come from the development of other sources of energy. I urge that an all-out effort be made, nationally and cooperatively, to develop the alternative sources of energy which will be absolutely essential to the continued expansion of world production and employment.

We are not energy ministers—we cannot make the decisions among alternative forms of energy or estimate the investment costs of these alternatives. But we know these costs will be enormous. And we know that, as economic and finance ministers, we will be responsible for considering how this capital will be raised and developing the policies that will allow massive sums to be diverted from consumption and other uses for this purpose. We must accept these costs. We must alter our budget priorities to help in these adjustments.

I concentrate on energy because this problem is critical. Unless we solve it, nothing we can do in other areas will give us the growth and price stability we need. But the energy area is not the only supply problem we must address. Our economies in general are not responding to changing demands as they once did and as they must. Productivity and investment are lagging badly in many of our countries. Industry is bound in a regulatory morass. Tax structures and levels in some countries stultify innovation and risk. Widespread indexation freezes income distribution and incentives for movement between industries and sectors. Various protective devices lock in inefficiency.

These factors have varying degrees of importance for each of our economies. Viewed narrowly, each has its rationale in understandable social, institutional, or political terms. But each damages the capacity of our economies to adjust and adapt, and together they imply a staggering waste of human and material resources. These rigidities and inefficiencies, and consequent supply limitations, dictate cautious policies toward growth. And that, in turn, discourages the investment, improvement in productivity, and change that is needed to break out of the cycle. The task of dealing

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with these problems of economic structure is important for each of our economies alone, but also has important implications for the balance of payments adjustment process. To some degree, persistent and destabilizing imbalances among our economies are rooted in the same rigidities that plague our domestic economies. There is a clear need for countries in persistent deficit to pursue policies to facilitate movement of resources into the export and import-competing sectors; and for persistent surplus countries to remove impediments to imports and devote a higher proportion of domestic production to satisfaction of domestic demand.

The United States therefore welcomes the establishment of a new high-level group within the EPC to encourage positive adjustment policies by members. This group should help us understand how we might improve our economies' capacities to adjust and adapt to a changing world economy.

This restructuring, to have its full beneficial effect on the adjustment process and on the welfare of all of our producers and consumers, will need to take place in an open, liberal environment for international trade and investment.

We are pleased that this meeting is renewing our joint commitment to the trade pledge. The United States strongly supports the principles on which the pledge is based, and stands ready to endorse it once more along with the other members of the Organization.

The trade pledge was effective during the years we have worked to negotiate the MTN. This year's renewal provides for the transition time until the MTN becomes effective. I wish to congratulate all assembled here on their considerable contributions to a successful MTN. The OECD as an organization helped directly to prepare the way for the negotiations on government procurement, resulting in a major new code in an area formerly completely outside the scope of the international trading rules. It now is up to us as the world's major trading nations to ensure that the MTN agreements are fully and vigorously implemented. My Government looks forward to joining you in this task.

We are also gratified that the OECD Committee on International Investment and Multinational Enterprises was able to conclude successfully its review of the 1976 Investment Declaration and associated decisions. We are joining in the Council's reaffirmation of the Declaration and its endorsement of the Committee's conclusions and recommendations. But, as with the trade pledge, we believe there is a need to go further.

The United States is increasingly concerned about competition among governments in the use of incentives and disincentives with regard to international direct investment. We believe that such measures can divert investments from one country to another, thereby exporting one country's problems to others. In addition, we are concerned about the growing use of performance requirements to tilt the benefits of international investment in favor of the country which is applying them. Thus, we especially support the Committee's proposal for a new work program on incentives and disincentives. We hope that the results of the program will enhance our understanding of developments in this area, and provide a basis for further cooperation among the member governments of the OECD to curb such competition.

The overriding need for action on energy and structural adjustment seems clear to us here in this room. But, in many cases, the need to act is not clearly perceived by our peoples; the actions required involve sacrifice; and they offer no quick payoff. That must be our concern and our task—to build awareness of the situation in our own countries, to have the courage to take corrective action, and to persist with policies that will yield material results only in the medium term.

Mr. Chairman, the world has reached a stage where forceful, concerted action by our governments to expand supply and reduce structural rigidities in our economies has become an essential complement to traditional demand policy. We must not, of course, lose sight of the continuing need to maintain appropriate macroeconomic policies, to resist movement toward protectionist devices in response to immediate trade or payments problems, to maintain cooperation in dealings with exchange market disorder. But we need now to chart a longer, anticipatory, and in many ways more difficult, course to ensure that our economies meet their full productive potential in the years ahead.

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Exhibit 68.—Text of the declaration issued following the meeting of heads of state and government of Canada, the Federal Republic of Germany, France, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States of America, June 28, 1979, in Tokyo, Japan

The Heads of State and Government of Canada, the Federal Republic of Germany, France, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States of America met in Tokyo on the 28th of June, 1979. The European Community was represented by the President of the European Council and by the President of the European Commission for discussion of matters within the Community's competence.

1. The agreements reached at the Bonn Summit helped to improve the world economy. There was higher growth in some countries, a reduction of payments imbalances, and greater currency stability.

2. But new challenges have arisen. Inflation, which was subsiding in most countries, is now regaining its momentum. Higher oil prices and oil shortage have reduced the room for maneuver in economic policy in all our countries. They will make inflation worse and curtail growth, in both the industrial and developing countries. The non-oil developing countries are among the biggest sufferers.

We are agreed on a common strategy to attack these problems. The most urgent tasks are to reduce oil consumption and to hasten the development of other energy sources.

Our countries have already taken significant actions to reduce oil consumption. We will intensify these efforts.

The European Community has decided to restrict 1979 oil consumption to 500 million tons (10 million barrels a day) and to maintain Community oil imports between 1980 and 1985 at an annual level not higher than in 1978. The Community is monitoring this commitment and France, Germany, Italy and the United Kingdom have agreed to recommend to their Community partners that each member country's contribution to these annual levels will be specified. Canada, Japan and the U.S. will each achieve the adjusted import levels to which they are pledged in IEA (International Energy Agency) for 1979, will maintain their imports in 1980 at a level not higher than these 1979 levels, and will be monitoring this.

The seven countries express their will to take as goals for a ceiling on oil imports in 1985 the following figures:

- For France, Germany, Italy[1] and the United Kingdom: the 1978 figure.
- Canada, whose oil production will be declining dramatically over the period between now and 1985, will reduce its annual average rate of growth of oil consumption to 1 per cent, with the consequent reduction of oil imports by 50,000 barrels per day by 1985. Canada's targets for imports will therefore be 0.6 million barrels per day.
- Japan adopts as a 1985 target a level not to exceed the range between 6.3 and 6.9 million barrels a day. Japan will review this target periodically and make it more precise in the light of current development and growth projections, and do their utmost to reduce oil imports through conservation, rationalization of use and intensive development of alternative energy sources in order to move toward lower figures.
- The United States adopts as a goal for 1985 import levels not to exceed the levels either of 1977 or the adjusted target for 1979, i.e. 8.5 million barrels per day.

These 1985 goals will serve a reference to monitor both energy conservation and the development of alternative energy sources.

A high level group of representatives of our countries and of EEC Commission, within the OECD, will review periodically the results achieved. Slight adjustments will be allowed to take account of special needs generated by growth.

In fulfilling these commitments, our guiding principle will be to obtain fair supplies of oil products for all countries, taking into account the differing patterns of supply,

[1]Italy's commitment with reference to the 1978 level is accepted in the context of the overall commitment of the European Community.

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the efforts made to limit oil imports, the economic situation of each country, the quantities of oil available, and the potential of each country for energy conservation.

We urge other industrialized countries to set similar objectives for themselves.

We agree to take steps to bring into the open the working of oil markets by setting up a register of international oil transactions. We will urge oil companies and oil exporting countries to moderate spot market transactions. We will consider the feasibility of requiring that at the time of unloading crude oil cargoes, documents be presented indicating the purchase price as certified by the producer country. We will likewise seek to achieve better information on the profit situation of oil companies and on the use of the fund available to these companies.

We agree on the importance of keeping domestic oil prices at world market prices or raising them to this level as soon as possible. We will seek to minimize and finally eliminate administrative action that might put upward pressure on oil prices that result from domestic underpricing of oil and to avoid new subsidies which would have the same effect.

Our countries will not buy oil for government stockpiles when this would place undue pressure on prices; we will consult about the decisions that we make to this end.

3. We pledge our countries to increase as far as possible coal use, production, and trade, without damage to the environment. We will endeavor to substitute coal for oil in the industrial and electrical sectors, encourage the improvement of coal transport, maintain positive attitudes toward investment for coal projects, pledge not to interrupt coal trade under long-term contracts unless required to do so by a national emergency, and maintain, by measures which do not obstruct coal imports, those levels of domestic coal production which are desirable for reasons of energy, regional and social policy. We need to expand alternative sources of energy, especially those which will help to prevent further pollution, particularly increases of carbon dioxide and sulphuroxides in the atmosphere.

Without the expansion of nuclear power generating capacity in the coming decades, economic growth and higher employment will be hard to achieve. This must be done under conditions guaranteeing our people's safety. We will cooperate to this end. The International Atomic Energy Agency can play a key role in this regard.

We reaffirm the understanding reached at the Bonn Summit with respect to the reliable supply of nuclear fuel and minimizing the risk of nuclear proliferation.

New technologies in the field of energy are the key to the world's longer-term freedom from fuel crisis. Large public and private resources will be required for the development and commercial application of those technologies. We will ensure that these resources are made available. An international energy technology group linked to the OECD, IEA and other appropriate international organizations will be created to review the actions being taken or planned domestically by each of our countries, and to report on the need and potential for international collaboration, including financing.

We deplore the decisions taken by the recent OPEC conference. We recognize that relative moderation was displayed by certain of the participants. But the unwarranted rises in oil prices nevertheless agreed are bound to have very serious economic and social consequences. They mean more world-wide inflation and less growth. That will lead to more unemployment, more balance of payments difficulty and will endanger stability in developing and developed countries of the world alike. We remain ready to examine with oil exporting countries how to define supply and demand prospects on the world oil market.

4. We agree that we should continue with the policies for our economies agreed at Bonn, adjusted to reflect current circumstances. Energy shortages and high oil prices have caused a real transfer of incomes. We will try, by our domestic economic policies, to minimize the damage to our economies. But our options are limited. Attempts to compensate for the damage by matching income increases would simply add to inflation.

5. We agree that we must do more to improve the long-term productive efficiency and flexibility of our economies. The measures needed may include more stimulus for investment and for research and development; steps to make it easier for capital and labor to move from declining to new industries; regulatory policies which avoid unnecessary impediments to invest and productivity; reduced growth in some public

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sector current expenditures; and removal of impediments to the international flow of trade and capital.

6. The agreements reached in the Tokyo Round are an important achievement. We are committed to their early and faithful implementation. We renew our determination to fight protectionism. We want to strengthen the GATT (General Agreement on Tariffs and Trade) both to monitor the agreements reached in the MINS (Tokyo Round of Multilateral Trade Negotiations) and as an instrument for future policy in maintaining the open world trading system. We will welcome the full participation of as many countries as possible in these agreements and in the system as a whole.

7. We will intensify our efforts to pursue the economic policies appropriate in each of our countries to achieve durable external equilibrium. Stability in the foreign exchange market is essential for the sound development of world trade and the global economy. This has been furthered since the Bonn Summit by two important developments—the November 1, 1978 program of the United States in conjunction with other monetary authorities, and the successful emergence of the European Monetary System. We will continue close cooperation in exchange market policies and in support of the effective discharge by the International Monetary Fund of its responsibilities, particularly its surveillance role and its role in strengthening further the international monetary system.

8. Constructive north-south relations are essential to the health of the world economy. We for our part have consistently worked to bring developing countries more fully into the open world trading system and to adjust our economies to changing international circumstances. The problems we face are global. They can only be resolved through shared responsibility and partnership. But this partnership cannot depend solely on the efforts of the industrialized countries. The OPEC countries have just as important a role to play. The latest decision substantially to increase oil prices will also severely increase the problems facing developing countries without oil resources as well as the difficulties for developed countries in helping them. The decision could even have a crippling effect on some of the developing countries. In this situation, we recognize, in particular, the need for the flow of financial resources to the developing countries to increase, including private and public, bilateral and multilateral resources. A good investment climate in developing countries will help the flow of foreign investment.

We are deeply concerned about the millions of people still living in conditions of absolute poverty. We will take particular account of the poorest countries in our aid programs.

Once more we urge COMECON countries to play their part.

We will place more emphasis on cooperation with developing countries in overcoming hunger and malnutrition. We will urge multilateral organizations to help these countries to develop effective food sector strategies and to build up the storage capacity needed for strong national food reserves; increased bilateral and multilateral aid for agricultural research will be particularly important. In these and other ways we will step up our efforts to help these countries develop their human resources, through technical cooperation adapted to local conditions.

We will also place special emphasis on helping developing countries to exploit their energy potential. We strongly support the World Bank's program for hydrocarbon exploitation and urge its expansion. We will do more to help developing countries increase the use of renewable energy; we welcome the World Bank's coordination of these efforts.

Exhibit 69.—Excerpt from remarks by Assistant Secretary Bergsten, July 18, 1979, before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations, on OPEC investments in the United States

Introduction

The events of the past few weeks have reminded us, as seldom before, of the intense interdependence between our own economy and that of other countries. The success

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of the United States in creating jobs for our workers, and in reducing the rate of inflation for all our people, depends critically on our ability to forge effective working relationships with a large number of nations—industrialized nations, such as those with which President Carter met at the Tokyo summit at the end of June, and developing nations, including some which supply to our economy critical raw materials such as petroleum.

Indeed, this interdependence should have been apparent to the American people for most of this decade. During the 1970's, we have felt the ravages of global inflation which turned quickly into global recession. Since 1973, we have experienced massive increases in the world price of oil which have produced dramatic changes in national balance of payments position and international financial developments, in addition to their impact on inflation and recession.

The stability of the world economy has been sorely tested by these events. Some observers predicted a collapse of the international financial system. Some predicted a return to the protectionism and beggar-thy-neighbor policies which deepened and broadened the Great Depression of the 1930's. Some even foresaw a resort to military means to protect access to raw materials or other vital national interests.

Fortunately for all of us, none of these dire events has occurred. To be sure, we continue to experience an intolerable level of inflation, the threat of at least a mild recession, concern about the dollar, and longer run worries about the availability of adequate supplies of energy. These issues will continue to preoccupy the President and the Congress of the United States for years to come.

But one piece of very good news is that the international economic system has held. Protectionism has been largely held at bay, and trade has in fact been liberalized through the multilateral trade negotiations (MTN) in Geneva. Balance of payments adjustment has taken place—the United States ran a current account surplus in the first quarter of this year, while Japan ran a current account deficit. The petrodollars have been recycled successfully. The debt problems of both industrialized and developing countries have been managed effectively. The industrialized countries have learned how to coordinate their policies much more effectively, including at Tokyo in the critical area of reducing oil imports.

This ability to cope can be largely attributed to the success of the United States, over the course of the entire postwar period, in leading the world toward the creation of an international economic system based on the market principles which have lain behind the unprecedented historical success of our own economy. The goal of the United States has been maximum freedom for trade, investment, and capital movements—and our success in pursuing that goal has created an interdependent world economic system in which all major countries best serve their own economic interest by adopting and maintaining policies which preserve and defend that system. Any retreat from that approach by the United States could jeopardize all that has been built, and with it some of our own most important economic, political, and philosophical objectives.

I begin my testimony with these references to international economic interdependence, and to the continuing themes of postwar U.S. international economic policy, because they provide the framework within which I will seek to answer the specific questions raised in the chairman's letter of invitation to me to testify today. These questions relate to the amounts and objectives of investment by OPEC countries in the United States, the impact of such investments on our economy and financial system, the adequacy of the data which are now collected on such investments by the U.S. Government, our policy on disclosure of certain of these data, and the ability of the United States to defend itself against any withdrawals of assets by foreign investors in the United States. I will address each of these questions in my statement, and provide annexes with detailed answers to each question raised in the chairman's letter.

The level of OPEC investments in the United States

A number of OPEC countries have experienced large balance of payments surpluses following the quadrupling of the oil price in 1974, and hence have had a substantial volume of money to invest outside their own borders. We estimate that residents of these countries had invested only a few billion dollars in the United States prior to

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1974. Since January 1, 1974, however, roughly \$46 billion—approximately 20 percent of estimated cumulative investable surpluses of all OPEC countries during that period—has been invested in the United States or used to amortize debt. Thus, we estimate the total value of OPEC holdings in the United States at the end of last year at about \$42 billion. About 80 percent comes from Middle East oil-exporting countries. These numbers should rise further in the next year or two: After dropping to only \$5 billion in 1978, the OPEC surplus is likely to rise again to over \$40 billion in both 1979 and 1980.

These are sizable numbers. However, in every case they represent a modest percentage of total foreign investment in the United States—and a tiny share of total investment, foreign and domestic, in such assets:

- The oil-exporting countries account for 9 percent of all foreign holdings of Treasury securities, and about 1.6 percent of all holdings of Treasury debt;
- They hold an estimated 20 percent of all foreign investments in U.S. corporate and other securities, but only about six-tenths of 1 percent of all outstanding U.S. equities and about seven-tenths of 1 percent of all outstanding U.S. corporate bonds;
- They account for less than 10 percent of all liabilities to foreigners reported by banks in the United States, and for less than 1 percent of the total of \$1.1 trillion of deposits held by Americans as well as foreigners in those banks;
- Their direct investment holdings amount to less than 1 percent of all foreign direct investment in the United States, and something on the order of one-hundredth of 1 percent of the net worth of all U.S. firms.

Hence it would be difficult to conclude that any possible withdrawals of investments of oil-exporting countries constitute a threat to the U.S. economy or financial system. The magnitudes involved would simply seem to belie any such possibility. Indeed, the first conclusion cited by the General Accounting Office in its report of July 16 to this subcommittee is that "these holdings do not constitute an immediate danger to U.S. banks or the economy."

A word of background on the nature of these investments in the United States by oil-exporting countries, particularly concerning how their official holdings differ from those of virtually all other countries, may be useful. Since World War II, the dollar has been the principal currency used in international trade and the principal currency used by monetary authorities when they intervene in the foreign exchange market to influence their exchange rate. When countries have increased their official reserves, most of those increases were acquired and held in the form of dollars. Most of these dollar reserves were, in turn, invested in U.S. Treasury securities or in bank deposits in the United States. Some were deposited with banks in the Eurocurrency market.

Most of the OPEC countries followed the same practice until 1974, when the price of oil was quadrupled (although some had had close ties to sterling). In most of these countries the revenue from oil exports accrued directly to the governments, not to private entities. To a considerable extent, the excess of revenues over the demand for foreign exchange from other government entities and the limited private sector was viewed in the traditional way as an increase in reserves. The monetary authorities tended to invest the funds in dollars—a substantial part in the United States, mostly in U.S. Government securities.

But for some of these countries the accumulations were such—and the prospect of further surpluses was such—that some of the funds were not really needed as liquid reserves, but could be used for longer term investments. In some cases, the monetary authority has continued to manage both the "reserves" and the "investments." In some, a separate agency was established to handle the funds not counted as reserves. There are a few non-OPEC countries (e.g., state trading countries) where various government entities other than the central bank hold dollars in the United States, but few if any instances of government-operated investment funds.

In U.S. statistics the bulk of these holdings of OPEC government agencies, whether considered by these governments as reserves or investment funds, are reported as liabilities to official holders. Our use of the term "investment" thus covers both types. In addition, U.S. liabilities to private entities in a number of OPEC countries are negligible whereas U.S. liabilities to private entities are substantial in most non-OPEC

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countries which have significant holdings in this country. Any discussion of OPEC investments in the United States must take account of these special factors.

The impact of OPEC investments on the United States

We are fully satisfied that the United States has benefited from the placement of these funds in the United States. We cannot, of course, guarantee that every foreign investment in the United States has brought identifiable gains to U.S. productivity. But the inflow of capital which these funds provided has helped finance our balance of payments deficits, added investment capital to foster domestic growth and create jobs, helped to finance the external lending activities of U.S. banks, and contributed to the strength of the dollar and the overall stability of the international monetary system.

The past three decades have been characterized by a progressive liberalization of international trade and capital flows, developments which have catalyzed rapid and sustained increases in the wealth and living standards of the industrial countries and progress in the developing world. Beyond the economic gains from specialization and efficient resource allocation, a result of this movement toward an open system of trade and capital has been an increasing degree of international economic interdependence. The industrial and agricultural structures of individual nations are now heavily dependent on sources and markets abroad.

The extent of U.S. involvement in world trade, and therefore in the global economy, is frequently overlooked.

- We are the world's largest exporter, in 1978 selling $140 billion in U.S. goods and $36 billion in U.S. services abroad;
- One out of every eight manufacturing jobs in this country, and 1 out of every 3 acres of American farmland, produce for exports;
- We import more than $170 billion in goods from abroad. These imports provide essential inputs for U.S. industry, including more than one-fourth of U.S. consumption of 12 of the 15 key industrial raw materials;
- Our total trade, exports plus imports, is now equivalent to about 15 percent of U.S. GNP, double the figure of just over a decade ago.

There is an integral relationship between the international flow of goods and the flow of investment capital. Countries—just like firms—cannot buy more than they sell unless they can borrow funds to finance the purchases. Similarly, there is no incentive for a country to sell more than it needs to buy unless there are opportuntties for safe and profitable investment of the surplus funds. Our economy is highly dependent on trade and a vigorous world economy. That, in turn, is dependent on an open system of international payments and capital flows.

The world and U.S. economies have benefited greatly from the expansion of world trade and capital flows, in terms of increases in employment and standards of living far greater than would have been possible if we and other nations had raised, rather than lowered, the barriers to international trade and payments.

An essential element in the preservation of an open trade and payments system has been our policy toward international investment. A country cannot run a deficit in its balance of payments on external account without financing the deficit through some form of capital inflow (except by selling off existing claims on foreigners). A U.S. readiness to accept foreign investment, including investment in dollars by foreign central banks, is a crucial element in the operation of the international monetary system.

We impose no restrictions on the use of the U.S. dollar by nonresidents, with minor exceptions to which I will refer later. Broadly speaking, nonresidents, whether official or private, have the same access to U.S. money and capital markets as have our own citizens. We do not discriminate on the basis of race, religion, nationality, color, or creed in the application of this policy any more than we do at home.

With respect to equity investments in U.S. firms, the principle is the same. Only in a few highly sensitive strategic industries, such as the production of fissionable material, has Congress called for restrictions on investment by foreigners that are not applicable to domestic residents. The question whether any special provisions with respect to the purchase of American banks by nonresidents are advisable is being discussed currently

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by the Senate Banking Committee. The Treasury does not believe that, at its present level, foreign ownership of banks poses any undue risk, although the situation should be followed carefully. The general, underlying principle is to afford the same privileges and responsibilities to the nonresident investor as to a resident. Therefore, we neither promote this type of investment by foreigners nor discourage it. So long as it takes place in response to market forces, we welcome it.

This policy is based on a careful and pragmatic assessment of the national self-interest, though it comports as well with our philosophical preference for open markets and a minimum degree of government interference. Investment in this country which originates from abroad should be no less beneficial to our economy than investment which originates here.

Concerns about OPEC investments

I understand the concern of this subcommittee to be not whether overall U.S. investment policy is right or wrong, but whether sufficient data are being collected and adequately analyzed to ensure proper implementation of that policy and of specific legislation with respect to the collection and analysis of data. You have indicated concern with the adequacy and analysis of information on the investments—financial and direct—of residents of the 13 countries which are members of OPEC.

The question of whether OPEC investments should be viewed differently from other investments presumably arises because most of these investments are made by government bodies in these countries. There is no basis for considering investments in the United States by private individuals or firms that happen to be residents of an OPEC country in a different manner than investments by residents of other nations. Obviously, however, there is a possibility that a foreign government could use its assets in the United States to pursue political objectives contrary to our national interests.

Considerable public concern was expressed about the possibility of politically motivated investments in the United States by foreign governments when a number of OPEC countries began to accumulate large amounts of funds. The Government responded to these concerns in 1975 by establishing a special procedure which called for advance notification to the U.S. Government of any major investment in the United States by a foreign government (excluding investments in U.S. Government securities, bank deposits, et cetera) and for review by a special interagency committee of any foreign governmental investments here which might have adverse implications for the national interest. This procedure was from the beginning, and is now, equally applicable to investments by any foreign government.

Executive Order 11858 of May 7, 1975, established the Committee on Foreign Investment in the United States, consisting of representatives of the Departments of Commerce, Defense, State, and Treasury. The order assigns the Committee responsibility for "monitoring the impact of foreign investment in the United States, both direct and portfolio, and for coordinating the implementation of United States policy on such investment." In particular, it mandates the Committee to "review investments in the United States which, in the judgment of the Committee, might have major implications for United States national interests." The Committee gives us an orderly procedure for examining these questions to make sure that any action, or inaction, by the Government is based on carefully considered judgments of what is in the national interest.

Since the establishment of this procedure, there has been only one proposed investment by an OPEC government which was of sufficient significance to warrant its use. This was a proposed investment in the Occidental Petroleum Co. by the Government of Iran in 1976. The proposal was eventually withdrawn for business reasons unrelated to the U.S. Government review. Thus, to date there have been no instances of investments by the government of any OPEC member which have been considered significant in terms of control of, or influence in, a major U.S. enterprise. We estimate the total value of *direct* investment—the value of equity holdings in companies in which the foreign investor holds 10 percent or more of voting stock or its equivalent—in the United States by all residents of all OPEC countries at about \$325 million as of end-1978. This constitutes less than 1 percent of the direct

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investment in this country by foreigners, and is not a volume which poses a threat to our national interests.

In addition, it is worth pointing out that the Government of Saudi Arabia has stated publicly that a central feature of its investment policy is to limit its holdings to a maximum of 5 percent of the equity in any company. We understand that investment managers handling Saudi portfolios have been specifically instructed to observe this limit. Private Saudi citizens have made several direct investments in this country, but it is the clear policy of the Saudi Government and monetary authorities to eschew such initiatives.

The subcommittee has raised the question of whether other kinds of OPEC investments in the United States—mainly financial instruments—are so large that our financial markets are unduly dependent on, and vulnerable to, one or a few governments who could take disruptive action for political reasons.

I have already noted that the approximately $24 billion which constitutes total holdings of U.S. securities by all residents of all OPEC countries combined is not a large enough component of our markets to constitute a major threat to our financial system. The U.S. equity and capital markets are by far the broadest and most resilient financial markets in the world. In the very unlikely event that all of the OPEC countries dumped their entire holdings of U.S. securities at one time, the markets would absorb these securities at a significant but manageable price concession. The effects might be pronounced and undesirable—but they would clearly be manageable. As money is fungible, most of the impact would be quickly offset. The OPEC countries would either reinvest their dollar proceeds in dollar-denominated investments abroad, or would exchange these dollars for other currencies. In either event, those foreign institutions that acquired the dollars from OPEC countries would, directly or indirectly, have to reinvest the funds in the United States.

It is important to recognize that withdrawal of dollar deposits from U.S. banks by foreign depositors, and their transfer to European banks, does not affect U.S. domestic liquidity. What is transferred is ownership of the dollar deposits, which in this case become the U.S. bank's liabilities to European banks as opposed to liabilities to the original foreign depositors. The U.S. bank still has the same liabilities available to support its asset structure. There are no actual dollars in the Eurodollar market, which is in fact a market in claims on deposits in U.S. banks, and not a market in greenbacks.

It might be worthwhile to elaborate this point. If an American firm drew a check on a bank in New York in favor of an OPEC government to pay oil royalties, the New York bank's liabilities to the firm would decline and its liabilities to the OPEC government would rise. Our data would then show an increase in U.S. bank liabilities to foreign official holders. If the OPEC government then transferred its deposit to a bank in London, the liabilities of the New York bank to the OPEC government would go down and its liabilities to the London bank would rise. Our data would show a decline in U.S. liabilities to official holders abroad, but an equal increase in liabilities to private foreigners—a decline in our liabilities to residents of OPEC countries and a rise in our liabilities to residents of the United Kingdom. Neither the asset-liability position of the bank nor the U.S. money supply would be affected.

If a particular bank in the United States were to be faced with a demand for an immediate withdrawal of a very large deposit, it would have numerous ways to meet that demand. To begin with, most OPEC bank deposits are not held in demand deposit form but are subject to withdrawal limitations or penalties. The mere sale of a certificate of deposit by an OPEC holder to a non-OPEC entity would not place pressure on the bank in which that certificate of deposit is held. Pressure could be applied only by demanding immediate payment. Should such a demand be made, the bank could borrow in the interbank market.

The international banking system is accustomed to interbank borrowings which may total in the billions of dollars daily and would probably be able to handle any attack on an individual bank easily. One reason there would be no difficulty is that the funds withdrawn from one bank would have to be deposited with some other bank. The bank receiving the new deposit would find itself with excess funds which it would immediately offer in the interbank market. But even in the unlikely event that funds were not easily obtainable in the interbank market, a bank facing a large deposit withdrawal could borrow from the Federal Reserve. Governor Coldwell may

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elaborate on this point, but the Federal Reserve serves as a lender of last resort for banks in the United States.

Similarly, the United States has fully adequate defenses against any attempt to disrupt the U.S. Government securities market by dumping large holdings. The Federal Reserve Bank of New York maintains a secondary market for U.S. Government securities and could immediately purchase for its own account or, if necessary, for the account of the Treasury, whatever amount of such securities might be needed to maintain order in the markets. Obviously we try to avoid disruption in the securities markets, and one of the purposes of the add-on arrangements which we established for the use of governments and central banks has been to facilitate both the purchase and the sale of large amounts without disturbing the market.

Concerns have also been expressed that one or more OPEC governments might attempt to damage the United States by suddenly dumping large amounts of dollars on the foreign exchange market. Several OPEC central banks hold sufficient dollar-denominated assets, either in the United States or in the Eurocurrency market, to cause considerable disorder in the foreign exchange market under certain conditions should they deliberately attempt to do so. (So, for that matter, do a good many non-OPEC central banks.) One does not need detailed statistics or a detailed analysis of individual country holdings to conclude that such capability exists.

Such events are unlikely, however, for several reasons. The first is the strong interest of major OPEC countries, expressed repeatedly by them, in the stability of the exchange rate of the dollar. Most of the investments of nearly every OPEC country are denominated in dollars, and a depreciation of the dollar reduces the value of those assets in terms of other currencies.

In addition, OPEC countries price their oil in dollars. A depreciation of the dollar in effect thus reduces the value of their oil revenues, in terms of what they could buy in many other countries.

Finally, such a political attack would have obvious implications for overall relationships between the countries involved and the United States. The likelihood of a politically motivated attack on the dollar thus seems very remote.

Even if there were a politically motivated attempt to damage the dollar, we have extremely strong defenses to counter it, as pointed out in the GAO report. Private banks themselves could readily borrow abroad, or through the domestic interbank market, to offset immediately the impact of withdrawals. If official action became imperative, authority exists under the International Emergency Economic Powers Act for the President to declare a national emergency and to block any withdrawals of assets.

In addition, we could count on help from abroad. Other countries, both developing and industrial, have a very great stake in preserving international monetary stability. Central banks of countries whose currencies were being purchased would not wish to face either the effects on their exchange rate and their domestic economy, or the effect on their money supply, of providing the domestic currency themselves. I am confident that we could count on widespread cooperation to counter such a misguided attempt.

Your letter also implied a concern that OPEC governments might gain undue influence in specific U.S. companies, or specific sectors of the economy, by secretly acquiring a controlling or influential interest in particular companies by means of anonymous acquisitions of their securities, through nominee accounts in non-OPEC countries, or other indirect methods.

Any such acquisitions would contravene current laws and regulations regarding reporting of foreign investment in the United States. The Securities and Exchange Commission requires that any person acquiring more than 5 percent of a publicly traded U.S. company must report this fact to the SEC. Regulations issued by the Commerce Department under authority of the International Investment Survey Act of 1976 require that any U.S. company whose voting stock is 10 percent or more owned by a foreign resident must report quarterly to the Commerce Department if the value of its assets, sales, or income are more than $5 million.

Obviously, there is a theoretical possibility that a foreign person determined to acquire a controlling or influential interest in a U.S. company secretly could do so by working through various intermediaries and nominee accounts. It is conceivable that some foreign firms or individuals have a larger interest in more U.S. firms than now

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appears on our records. But the possibility that any foreign *government* has acquired such interests in this way in a large number of firms, or firms which are important to our economy, is too small to merit the establishment of an extensive organization to investigate such possibilities.

But let us assume for purposes of discussion that a government has acquired controlling interest in a U.S. firm which is below our reporting threshold and of which we are therefore unaware. Could a foreign government, using secretly held equity, shape the operations of a U.S. company in a manner that we would consider undesirable? The key point here is that the laws and regulations which we now have on the books presumably cover all potential abuses or misuses of U.S. companies. These laws are applicable equally to U.S. and foreign-owned companies in the United States, and their effectiveness is not dependent on our having detailed knowledge on whether particular foreigners own particular amounts of particular companies.

Therefore, any concerns about foreign investors misusing U.S. companies presumably relate to actions of some sort which are not now covered by U.S. laws. If, in fact, particular actions are a real threat to the national interests we should have laws against them regardless of whether the actions are perpetrated by foreigners or by Americans. But we should not have laws or reporting regulations which are based on the assumption that certain actions by foreign-owned companies—whether official or private—in the United States are intolerable even though the same actions by U.S.-owned companies would be acceptable, except in a few instances which Congress has decided to legislate such differential treatment.

For all these reasons, we see no basis for differentiating between OPEC investments in the United States and those by other foreign persons. Nor do we see a case for substantially increasing the burdens on American companies to supply more data than they now provide on these investments.

I would also like to point out that, just as we should not discriminate against OPEC investments in this country, neither should we discriminate in favor of such investments. In the Conference on International Economic Cooperation, during which there was extensive dialog between industrial countries and developing countries, some OPEC officials contended that preferential treatment for their investments was warranted in exchange for oil production in volumes excessive to their own immediate financial needs. We and the other industrial countries rejected this approach. Thus, while we welcome investment in this country by residents of OPEC countries, just as we do investment from other countries, we give no special incentives to attract it.

Notwithstanding our ability to cope with a withdrawal of OPEC investments from the United States, we would not want to precipitate such withdrawal. As I have said, these investments provide distinct benefits to our economy. Withdrawal also could have disruptive, if manageable, effects on our capital market. As the GAO report noted, withdrawal of the investments would adversely impact on the customer relationships which have been established between the OPEC countries and our banks and other enterprises—hurting their competitive position over the longer run. Measures which would force a withdrawal of OPEC investments would cast a pall on the investment climate in the United States, and could lead other foreign investors to reevaluate the desirability of maintaining their investments here as well.

Data on OPEC investments in the United States

When the oil price was quadrupled in 1974 and some of the OPEC countries began to accumulate large payment surpluses, the disposition of those surpluses became a matter of major importance not only to the surplus countries themselves but also to the entire world. In the national interest of the United States and the interest of world financial and economic stability, the U.S. Government sought to make clear to OPEC countries that investment in the United States—particularly in U.S. Government securities—would be welcome.

Since the amounts of the surpluses were extremely large and the U.S. monetary authorities wanted to minimize the impact of large purchases by foreign governments on the U.S. securities markets, Treasury offered facilities for the purchase of regular U.S. Government securities off-market but at market rates—the so-called "add on" facility. The same facilities were offered to other interested governments. In addition,

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in reponse to requests from officials of some OPEC countries, Treasury officials assured those countries that the confidentiality of their government accounts in the United States would be maintained.

In 1974, Treasury found it necessary to make significant changes in its reporting systems with regard to the portfolio transactions of the Mid-East oil-exporting countries in order to continue to afford confidentiality to individual investors there. Prior to that time, Treasury required reporters to submit data on liabilities to these and a number of other countries only semiannually, and then only for specific transactions. These partial data were published by country in the Treasury Bulletin. The requirement for only partial, infrequent reports on these countries was based on the fact that their holdings in the United States were very small; there was little need for comprehensive, monthly reports which would increase reporter burden. The small size of these holdings also reflected a situation where the data collected for each country represented a mix of holdings by banks, other private residents, and official institutions.

In 1974, the holdings of residents of Mid-East oil-exporting countries in the United States began to increase rapidly. Consequently, Treasury felt it advisable to change the reporting instructions to require monthly reports and to cover the whole range of portfolio transactions by residents of these countries. At the same time, as a result of the substantial increase in official oil revenue of these countries, it became obvious that the assets held in the United States by a number of official monetary authorities would constitute a very high percentage of the total holdings of residents of those countries—as has remained the case since that time. With this development, the continuation of the previous practice of publishing an individual country breakdown would have effectively disclosed holdings of these individual official institutions. Thus it became necessary to group countries in order to maintain confidentiality, as requested by some of the countries involved.

Throughout the period of data collection under the Bretton Woods Agreements Act and the International Investment Survey Act, the U.S. Government has sought to maintain the principle of confidentiality of the accounts of individual investors and reporters. An assurance that accounts of individual OPEC governments would be kept confidential, therefore, cannot be viewed as an offer of preferential treatment. Such confidentiality is available to all other governments as well as to private investors, domestic and foreign.

The sensitivity of governments and central banks to U.S. statistical treatment of their accounts varies. The Canadian Government, for example, has for many years accepted specific identification of its official holdings in the United States, but no other government's holdings have ever been specifically identified in U.S. statistics.

There are some instances in which U.S. liabilities to official institutions have come to constitute a relatively high percentage of U.S. liabilities of a particular type to all residents of that particular country. This is a situation which has evolved over the years as an increasing percentage of private liquid dollar balances came to be deposited in the Eurodollar market, rather than directly in the United States, while central banks of many nations were increasing their official dollar reserves substantially and continuing to hold those reserves in the United States. In the absence of expressions of concern by these governments, we have not changed our statistical presentation because we wish to make as much information available to the public as is consistent with individual customer and individual reporter concerns. However, very rarely are the percentages of official holdings in a country's total holdings as high for other countries as for the OPEC countries which have expressed concern over the issue.[1]

[1] Upon rereading my letter of Apr. 19 to the GAO, I have concluded that its fifth paragraph may have conveyed a misleading impression which I wish to clarify. The disclosure policy of the Treasury has been applied uniformly in the sense that confidential treatment is available to any investor (1) whose investments could be disclosed, contrary to the Bretton Woods Agreements Act and the Investment Survey Act of 1976, by publication of the individual country data and (2) who wishes to take advantage of it. The Government of Canada has indicated that it has no objection to disclosure of its holdings, which are therefore disclosed. The governments of several OPEC countries have indicated that they would object to disclosure of their holdings, which would in fact occur if data for those individual countries were reported because official holdings represent such a high share of total country holdings; thus these countries are grouped with several others to avoid disclosure of the holdings of individual investors. No other governments have objected to our longstanding presentation, so we have not felt it necessary to alter our presentation. Any government which did indicate a desire to avoid disclosure of its holdings, where those holdings were found to represent the bulk of the country's total holdings, would receive similar treatment.

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The United States is not alone in providing protection against the disclosure of the affairs of individual customers and reporters. As far as we know, no government divulges detailed data on the investments of individual investors, including individual foreign governments or central banks. No major country releases data on the holdings within its territory of individual Middle East oil-exporting countries. Indeed, no other country discloses nearly as much data as does the United States in this whole area of international capital movements.

The subcommittee has asked whether such treatment should continue to be extended to foreign governments. I would answer in the affirmative, for those who consider it important.

Most governments and central banks around the world—not merely those that are members of OPEC—consider that the details of their holdings abroad are a private matter. Most governments and central banks publish the total amount of their official reserves and give a breakdown between SDR, their IMF position, foreign exchange, and gold. Very few countries release a breakdown of their foreign exchange reserves by currency, but it is widely known that, for most countries, the great bulk of those holdings are in dollars. It is known that the major industrial countries hold most of their dollars in U.S. Government securities. Thus they have not expressed concern over the publication of disaggregations in which official holdings have come to constitute a high percentage of the country total.

Whenever and to whatever extent confidentiality is sought, however, we do our best to maintain it. Some OPEC countries may be more sensitive on this issue than some of the industrial nations whose external government-owned assets are all in the category of liquid reserves because, as I noted earlier, some of their holdings are more akin to an investment portfolio than liquid reserves. Nevertheless, the basic principle is available to all.

Finally, the chairman's letter of June 26 raised the question of whether "some form of understanding, promise, agreement, or arrangement" exists between the United States and any OPEC country regarding data disclosure. I have already indicated that several OPEC countries have repeatedly expressed concern about the confidentiality of their investments in the United States, leaving a clear implication that they might be less inclined to invest here in the absence of such confidential treatment. I have also indicated that the Treasury Department, in expanding its reporting on investments by OPEC residents, changed its treatment of the holdings of some OPEC countries in 1974, in conformity with the requirements of the Bretton Woods Agreements Act, in light of the requests of these countries that it do so.

The Treasury files contain no evidence of any explicit agreement on the subject, although former Secretary Simon has indicated that such an agreement did in fact exist. We can assure the subcommittee that no such arrangement has ever been mentioned, let alone agreed or carried on, during the present administration—though representatives of several OPEC countries have reiterated to us on several occasions their concern over the continuing confidentiality of their holdings. Indeed, the level of investments in the United States by these countries has fluctuated rather widely during the past few years, which is inconsistent with the notion that any such arrangement was in place at least during that period.

The primary determinant of the level of OPEC investments in the United States is the level of the OPEC investable surplus. The proportion of this surplus invested in the United States ranged from 21 percent in 1974 to a high of 30 percent in 1976 and fell back to a level of 14 percent in 1978. From mid-1978 through the first quarter of 1979, OPEC investments in the United States actually declined. The principal reason was that, during that period, these countries had no significant surplus while they had continuing commitments for grants and disbursements on earlier loan commitments.

I have attached to my testimony as much of the detailed information which the subcommittee has requested on all of these topics as is available to us, and as I can disclose. We have provided to the subcommittee over 300 documents from our files containing material relating to these investments which do not bear a national security classification. We have also provided lists of other documents, copies of which we have not provided for several different reasons.

We have been unable to furnish classified materials because, in response to our question as to whether the subcommittee and its staff would maintain the confidentiali-

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ty of classified documents, we were told that the subcommittee would wish to reserve for itself the right to release any documents it received. If the subcommittee should now be of the view that it can give such assurance, we would be pleased to supply all appropriate documents.

We also cannot supply some of the more detailed data requested because they would reveal the identity or holdings of an individual reporter, or an individual customer of a reporter. This is the case with respect to information relating to individual OPEC countries in the Middle East and in Africa. To avoid disclosing information that would reveal the accounts of these individual investors, Treasury groups data for the eight oil-exporting countries in the Middle East and data for four oil-producing countries in Africa in the tables which it publishes.

Avoidance of such disclosure is called for by the International Investment Survey Act and the Bretton Woods Agreements Act, under which these data are collected. Neither the acts nor their legislative histories contain any suggestion that an exception to the confidentiality requirements is to be made for Congress. In statutes under which Congress has intended that it have access to information which is to be kept confidential according to the mandate of those statutes, Congress has explicitly indicated that intention. The opinion of Treasury legal counsel on this issue is appended to my testimony.

Conclusion

I welcome this opportunity to discuss in detail with the subcommittee the application to OPEC countries of U.S. policy toward foreign investment in the United States. I have reached several conclusions in the course of my testimony:

That OPEC investments in the United States, while large in absolute terms, represent a small share of every category or foreign investment in the United States and an extremely small share of total investments, domestic and foreign, in this country;

That the interests of the OPEC investors themselves, and their clearly stated policies, suggest little likelihood that they would ever try to disrupt our economy or financial system by withdrawing their investments here;

That, if they did, we have ample defenses against actual disruption through the workings of the private banking system, existing legislation, and cooperation from other major countries;

That it would not be in the national interest of the United States to deter OPEC investments in this country any more than it would be to deter investments from other countries, and hence we respect the desires of some OPEC countries to maintain confidential treatment for their investments here, as clearly authorized by U.S. law; and

That a reversal of these policies, whether by changes in law or in current practice, would clearly discourage foreign investment for no apparent public purpose.

Within this framework, we have supplied—and will continue to supply—the maximum amount of data which we are free to supply under current law.

I look forward to continuing to discuss these issues with you.

* * * * * * *

Exhibit 70.—Statement by Under Secretary for Monetary Affairs Solomon, August 27, 1979, before the Alpbach European Forum (Economic Symposium), Alpbach, Austria, on international monetary relations

I am delighted to participate in this symposium on international monetary relations. The conference organizers asked originally that I speak about the dollar and the new European Monetary System. That relationship is an important one. But I think it equally important and illuminating to consider the broader evolution of our global monetary system. That will define the framework for relations between the dollar and the EMS. And we are at a point where, I believe, a clearer definition is both needed and feasible.

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All of us here are familiar with the intensive discussions of international monetary reform conducted in the Committee of Twenty earlier in this decade. We recall the ultimate decision not to conclude a revolutionary restructuring of the world's monetary order, but to accept a more flexible and pragmatic course that would accommodate the need for more flexible exchange rates, improve the adjustment process, and permit the system to evolve gradually in response to changing needs. The negotiators considered, but could not agree upon, a highly structured system, investing a large degree of authority in a central body or in a set of precise rules for national economic behavior. Their decision was shaped in part by recognition that the energy crisis emerging at that time would bring vast and important changes, and that those changes could not be predicted with assurance.

That decision was realistic. Even the highly flexible system then adopted has encountered serious strains and, at times, disruption. There is a legitimate desire for greater order and stability. But at the same time, we must acknowledge that the world has survived drastic economic upheaval, and abrupt shifts in payments patterns, without general resort to damaging restrictions. With great and prolonged effort, our economies have dug out of the deepest recession in the postwar period. Our open system of international trade and capital flows—now bolstered by the recent MTN agreement—is alive and functioning vigorously. In a real sense, we weathered the storm. Had the C-20 negotiators chosen the alternate course, and attempted to install the monetary superstructure that they were then considering, it seems likely that apparatus would have been swept away by subsequent events, and the world economy would today be considerably bleaker.

Yet the experience of the past 5 years has been instructive. Our interdependence has been brought home forcefully. We know our dependence on imported oil. We know that when the anchovies stray from their usual habitat, the entire world suffers a protein shortage that has real and extreme consequences, both for consumers and producers of substitutes. We know that inflation, or downturn in production, in one of our economies affects us all. The success of our postwar decision to create an open, cooperative and efficient world trade and payments system has brought unquestioned benefits. But it has also brought, in my judgment, a transcending need for the world to better organize, coordinate and, ultimately, manage its economic policy on a global basis.

The disruptions of the 1970's were not, in the end, a consequence of failure of this or that monetary mechanism. Par values and convertibility could not have survived. Floating, in any pure sense, was not the answer then and isn't now, although flexible rates and a generally flexible attitude toward exchange rate adjustment, have helped ease—and correct—difficult balance of payments problems.

The problem is much larger, and one that the world has to face: Whether it is prepared to contemplate openly a partial ceding of national authority over economic policy to an international body. I pose this question in full knowledge that such a step is not politically realistic today. But real national authority and autonomy are limited in any case by the fact of our interdependence. The question is whether we learn to coordinate management of our economies, to the benefit of all concerned, or whether, because of the strains and pressures arising from our interdependence, we end up retreating from the thrust of the past three decades and slipping back into a nationally oriented and ultimately autarchic international regime. The pressure of events is forcing us toward a choice. There is no viable in-between in the long run—and the long run is getting shorter and shorter.

I should leave no question where my own choice lies. I believe that we have all benefited from the vibrance and growth of the world economy, and from the increased interdependence that has been part and parcel of that growth. It does not seem to me that a reversal of this trend—through conscious decision, or through failure to act together—can possibly be of benefit to the United States or the world at large.

Indeed, I consider it highly fortunate that the monetary negotiators earlier in this decade, despite the practical problems of agreeing upon and implementing at one time a full-scale reform, were able to lay the groundwork for the gradual evolution of much more effective and coherent management of the world economy.

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That groundwork exists in two important provisions of the amended IMF Articles of Agreement. They are stated in arcane terms, but they reach the essence of the problem.

The first gives the IMF an explicit role in surveillance over members' exchange rate policies and the balance of payments adjustment process.

The second establishes the objective of making the SDR the principal reserve asset in the international monetary system.

Together, these provisions—dealing with adjustment on the one hand and liquidity on the other—provide a basis for the evolution of a strengthened IMF role in guidance over the system as a whole. In the area of surveillance, the Fund has adopted principles for the guidance of members in conducting exchange rate policy, and procedures and criteria for use by the Fund in assessing members' policies. The guidelines, and IMF practice in exercising surveillance, recognize that the effort cannot be confined to exchange rate policy narrowly defined, but must be broader. It must encompass domestic economic policies, as they affect the balance of payments adjustment process. The surveillance provisions give the IMF enhanced capability to advise not only countries in balance of payments deficit, but also those in surplus, on the international implications of their policies and on approaches they might appropriately follow to correct their payments imbalances. They give promise of providing a more symmetrical approach to the adjustment process, which is essential to an effectively functioning system.

Progress in implementing the IMF's surveillance role has been cautious and deliberate. This is understandable, given the very short time that these powers have existed, and the need to respect member governments' desires to preserve the limited autonomy they have in an integrated international economy. Yet it is clear to me that this power of the IMF must be developed and strengthened, if we are to achieve genuine and lasting monetary stability on a global basis. The focus of the surveillance provisions is right—on the underlying conditions that are a prerequisite for stability. But the test is in making those provisions an effective framework for policy coordination, and ultimately policy direction, by the IMF.

In the area of international reserves and liquidity, renewed attention is being given to the development of the role of the special drawing right over the longer term. A decade ago, the SDR was seen as a potentially important innovation, a means of creating needed world liquidity without a concurrent buildup in official holdings of dollars. Creation of the SDR, however, did not address the problem of payments imbalances, nor the continuing expansion of both the demand for and supply of liquidity in the form of dollars and other currencies. In the C–20 discussions, a central role for the SDR was envisaged by all parties. And, despite the C–20's decision not to attempt to establish a highly structured system, the objective of making the SDR the world's principal reserve asset was incorporated into the amended Articles.

That objective remains in accord with the main body of thinking today. It is widely felt that the stability of the system as a whole would be well served by increasing reliance on a single, internationally created and managed, reserve asset. Even though we cannot know all of the implications of this type of evolution of the system, it is clear that the pressures of the past few years are reminders of the problems that can be caused if there are substantial shifts among reserve currencies—not only in terms of the exchange markets but also in terms of the impact on domestic monetary and economic circumstances in the countries concerned. At the same time, with the existence of large international financing needs and in the absence of a practical alternative, the scale of reserve holdings in the form of currencies has grown enormously. There is little reason to expect that situation to change unless conscious steps are taken to make it change. An increasing role for the SDR, holding potential for more active management of international liquidity through the IMF over the longer term, would be an important complement to enhanced IMF influence over balance of payments adjustment through its surveillance provisions.

Certainly from a U.S. viewpoint, enhancement of the role of the SDR is a legitimate and desirable direction for the system's evolution. The large international role of the dollar today is itself the product of an evolutionary process, arising from the predominance of the U.S. economy in the early postwar years, the mechanics of the Bretton Woods system, and the scope, openness, and strength of the U.S. financial

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markets. We are sensitive to the responsibilities inherent in the current role of the dollar and determined to maintain dollar stability, although developments in the world economy over the years suggest some basis for a gradual reduction in the dollar's relative role. Many economies have advanced rapidly relative to the U.S. economy, as well as in absolute terms. Capital markets in several countries have become larger and more efficient, and earlier controls over capital flows have in many cases been relaxed. The formal and technical arrangements of the current monetary system do not compel reliance on the dollar for intervention and reserve purposes. The formation of the EMS, with its emphasis on intervention in the currencies of participants rather than dollars, represents a significant shift in this respect.

But despite these underlying changes, the United States continues to supply the world's liquidity to a disproportionate degree, and others have not fully assumed the role that would appear justified by their domestic economic and balance of payments strengths. It would be costly and damaging to the world economy for the United States to attempt to reduce the openness of its capital market. What is needed is a more positive attitude and further action on the part of others to share more evenly the responsibility of meeting the world's credit needs. Further steps can be taken in the removal of exchange controls and other restraints on access to capital markets. In addition, the EMS may offer important potential. Phase II of the EMS envisages the institutionalization of the ECU as the key instrument in intra-EC settlements. It is clear that the ECU can strengthen and help solidify the European regional arrangement, but there is a question whether EMS participants will permit, and perhaps encourage, a wider role for the ECU. Many have sought to discourage a reserve role for their own national currencies. The ECU may provide an alternative that could facilitate a greater European role in meeting world credit needs without at the same time moving the reserve system toward still greater reliance on national currencies. Although such a development could constitute a forward step, it would not, of course, provide like the SDR a full answer to the ultimate goal of establishing a single international reserve asset, subject to decisions of the international community as a whole.

It should be evident from these comments that the United States has no wish to preserve artificially a particular role for the dollar even though we recognize its current importance and are determined to ensure its stability. A gradual reduction in the dollar's relative international role would appear consistent with underlying developments in the world economy, and that prospect, if it materializes, does not cause difficulty for the United States. Rather, our objective is to assure that any change be accomplished smoothly and consistently with the requirements of a stable, open, and growing world economy. Development of the SDR as a more prominent, accepted, and useful asset could contribute to orderly change and evolution toward a better managed reserve system.

The IMF membership has already taken a number of steps to enhance the role of the SDR. We have agreed to resume allocations, taken action to bring the SDR interest rate more closely into line with market rates, and expanded the uses that may be made of SDR's. Most recently, the IMF has begun intensive examination of the possibility of establishing a so-called substitution account, which could accept deposits of dollars in exchange for SDR-denominated claims on the account.

The concept of a substitution account is not new. Such an account in a different form was an important element of most reform plans considered by the C–20. Even though no such account was established at the time, there was widespread agreement that the possibility should be kept under study. It is appropriate to examine the idea afresh, as a possible contribution to renewed evolution toward greater reliance on the SDR.

A substitution account, properly designed, would offer a number of attractions for the international community in general. The SDR, like the ECU, is a diversified instrument, inherently involving less exchange risk than holdings of a single national currency. The existence of a substitution account would thus provide an internationally sanctioned, nondisruptive means for countries to achieve a more diversified and stable reserve position without having to hold a number of national currencies. And implementation of an account would give important direction for the future as a concrete move toward wider use of a fully international asset—the SDR—rather than allowing us to fall by default into an unregulated multiple currency system.

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We must take considerable care to design an account that meets these objectives. It is not easy. It should, for example represent a lasting move toward the SDR, not a move to be reversed if circumstances change. In practice, the characteristics of the reserve asset issued by the account will have to be acceptable both to holders and to issuers of currency reserves, designed to satisfy the needs of countries in widely differing circumstances. At the same time, the instrument's characteristics should parallel those of the SDR as closely as possible which could, over time and with experience, imply further changes in the SDR itself. An account would have to incorporate an appropriate balancing of the rights and obligations of participants in a wide variety of circumstances, and—a particularly thorny question—an equitable division of any costs arising from its operations.

For any account to succeed—in order for the effort to give a meaningful sense of direction for the evolution of the system—it needs to have broad and genuine support and widespread participation by the international community. In the months ahead, we will determine whether that support exists. If it does not, we should be prepared to consider what other steps might be possible in order to help assure an orderly evolution of the reserve system.

It is important that we understand what can be expected, and what cannot be expected, of a substitution account. It should not be seen as a dramatic step or revolutionary change. It will not resolve recurring problems of payments imbalances, nor guarantee exchange market stability. It cannot prevent the strains on the international monetary system caused by the oil price increase and the related huge financing needs. It will not eliminate the problems of managing our national economies in an increasingly interdependent world. These problems, as I have stressed earlier, must be addressed through parallel development of the IMF's authority and influence over the adjustment process and through continued cooperation among major countries on macroeconomic and monetary policies.

But what a substitution account can do is important and worth doing. It would set out clearly the direction we intend to move in the future. It would represent a firm step toward increased reliance on an international reserve asset, holding potential for more active official management of liquidity. And it would provide a valuable opportunity to gain wider experience with the SDR, and set the stage for expanding its official and private roles further over the long term.

If the objective of enhancing the SDR's international role is confirmed and a substitution account established, there will remain a large agenda for future study and eventual negotiation. In my personal view two main points will be particularly worthy of consideration as time passes.

The first is whether a larger international role for the SDR implies not only a larger role in official reserves but also in private transactions and balances. Considerable attention has been paid in the current IMF discussions to giving the assets issued by the account a market orientation in order to enhance their liquidity and attractiveness. There are in addition broader reasons for promoting private use of the SDR, in terms of moving the entire system toward reduced reliance on national currencies. I know there is skepticism in private circles about private use of the SDR. But I feel this may be overdone. There has been some private experience with "basket" instruments, and the markets have demonstrated capacity for innovation and evolution in the past. The SDR would not be a difficult instrument for private borrowers and lenders to hedge. So I think there is a potential for development of a private role for the SDR. And if governments agreed that this was a desirable course, they could take steps to encourage it, for example, through denominating in SDR official borrowing for balance of payments reasons. There is no question that development of a large private role for the SDR would take time. But it is achievable and may prove to be highly desirable as the system evolves.

The second question is whether and to what extent our efforts to enhance the SDR's role in the system should be accompanied by more active official management of the demand for and supply of international liquidity. The very rapid expansion of international bank lending—all in national currencies and largely in dollars—has not only increased the system's reliance on national currencies but also raised concerns for the stability of the banking system. On the supply side, careful attention is presently being given by the major central banks to prudential questions and to the question

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whether there is a need for closer official regulation of the volume of international banking activity, paralleling that in domestic markets. On the demand side, we need to consider the possibility of extending the IMF's surveillance role over the adjustment process to cover advice on the appropriateness of borrowing by individual countries from the point of view of their own situations and that of the system as a whole. Such questions obviously have relevance to the conduct of national monetary policies and the effective functioning of the balance of payments adjustment process.

The questions I have posed in these two general areas are long range in nature, but they will have to be addressed and answered in time as we continue our efforts to manage our increasingly interdependent global system. For the nearer term, our discussions will concentrate more heavily on determining whether the objective of enhancing the SDR's role in the system should be confirmed along the lines of the current proposal and, if so, what implementing steps can be taken.

Before concluding, let me comment briefly on the current world economic situation and its relationship to the longer range questions I have been discussing today. I noted earlier that the world had adjusted with reasonable success to the oil price increases and other disruptions in the middle of this decade. It is particularly unfortunate that the world economy has again been thrown into a situation reminiscent in some ways of that earlier period, following the 60-percent increase in oil prices in the first half of this year. The OPEC surplus will again rise sharply, to something on the order of $40 billion. The oil-importing world will shift into heavy deficit. The poorer developing countries will be particularly disadvantaged. World growth will be reduced, inflation worsened in all countries. International financing needs will escalate, and we must anticipate the reemergence of some strains and financing difficulties on the part of individual countries.

But we should not overlook our strengths. The international financial system—private and official—has demonstrated a major capacity to respond to changing demands quickly and efficiently. Our arrangements for monetary cooperation are strong. The very large underlying imbalances among the major countries continue to narrow. The German surplus is dropping sharply, and the Japanese surplus has, for the time being, vanished. The U.S. position is strengthening rapidly and will move into moderate surplus next year. These shifts will provide a good basis for greater exchange market stability, and the United States is firmly committed to maintaining a strong and stable dollar. And the IMF, bolstered by the Supplementary Financing Facility and soon to be expanded by the quota increase approved last year, is in a good position to meet enlarged demands for balance of payments financing and adjustment programs on the part of its members.

In short, recent oil price increases will undoubtedly cause difficulties in the international financial area. The immediate situation will have to be monitored carefully, but our safeguards for the preservation of our open system of trade and payments are still strong. At the same time we must realize that present difficulties are in part a symptom of the longer run problem: managing an increasingly interdependent and vulnerable world economy. Preoccupation with short-term needs should not divert our attention from consideration of steps that can be initiated to guide the evolution of our system over the longer term.

In closing, let me make several points clear. The foremost aim of the United States, in working to improve the monetary system, is the orderly evolution of that system. In the process of surveillance, for example, we expect to receive advice from the Fund concerning our own policies, and will give that advice the most serious consideration. We expect others to do the same. In the discussions of a substitution account, we do not seek to force on other countries changes in the ways that they manage their reserves, but to offer an additional, attractive option that will give greater meaning to the objectives established in the amended Articles of the IMF and point the way toward a more stable reserve system in the future. In none of these efforts do we seek to avoid our responsibility to restore balance in our external accounts and maintain a sound and stable dollar. That obligation is clear and will be met. It is not our aim, now or in the future, to impede the progress of the EMS or interfere with the development of the ECU. Furthermore, we realize that the success of the EMS will depend in part on the stability of the international system as a whole, including the stability of the

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U.S. dollar, just as the operations of the EMS will have implications for the stability of the broader system.

We are faced with an increasingly acute need to decide together how we wish to manage our interdependent world economy. If we cannot move forward, there is real danger that we will slip back. It would be idle to think that strong, cooperative management will come easily or overnight. But we can, and should, set our course clearly and initiate steps that will effectively guide the system's evolution.

Exhibit 71.—Statement by Secretary Miller as Governor for the United States, October 3, 1979, at the joint annual meetings of the Boards of Governors of the International Bank for Reconstruction and Development and its affiliates and the International Monetary Fund, Belgrade, Yugoslavia

Mr. Chairman, Mr. McNamara, Mr. De Larosiere, fellow governors, distinguished guests:

On behalf of the United States, I want to express our appreciation to the Government of Yugoslavia for inviting us here. Yugoslavia's energetic and independent spirit has long attracted the world's admiration and respect. And Yugoslavia's full participation in the work of the IMF and the World Bank has shown how nations with different economic and political systems can cooperate to mutual advantage. We join the other participants in thanking the Government of Yugoslavia for its warm hospitality to us here in Belgrade.

My remarks today are addressed to one central theme. Restoring balanced growth to the world economy will require purposeful domestic adjustment on the part of all nations—large and small. The two international institutions whose work we are reviewing at this meeting can help us make these adjustments in effective and mutually reinforcing ways. We must make sure they are in a position to do so. We must make sure they have our support to do so. In the last analysis, however, the responsibility rests with each of us. My country, as the largest economy in the system, is determined to carry out that responsibility in full. Only when balance is regained, will it be possible to resume the steady economic advance we all desire.

Mr. Chairman, this is the final annual meeting of the Bank and Fund during the decade of the 1970's. It has been a decade marked by troublesome strains in the world economy. The will and ability of nations to cooperate internationally have been severely tested.

The underlying strains might easily have led individual countries to the pursuit of inwardlooking policies—to self-defeating efforts to protect their own limited interests at the expense of the broader interests of the community of nations. That this did not occur is convincing testimony to the vision of the architects of the Bretton Woods institutions, and the maturity and wisdom of their successors—the representatives of the governments gathered here today.

The difficulties of the 1970's are all too familiar. The gains that have been achieved despite those difficulties are less widely appreciated. In the face of unprecedented payment imbalances, severe inflation, and high and persistent unemployment, international cooperation has been strengthened in important ways:

- Agreement was reached on far-reaching trade liberalization;
- Flows of official development resources continued to expand;
- Private financial markets successfully channeled huge flows of funds from surplus to deficit countries, and developing countries gained access to these private capital markets on a substantial scale;
- Intergovernmental cooperation in exchange markets became stronger and closer;
- The IMF Articles underwent comprehensive revision, laying the basis for orderly evolution of the international monetary system

This progress was not accidental. Nations might have responded to the problems of the 1970's by imposing trade and capital controls, by cutting back aid, and by aggressive competition in exchange rate policies. If that had happened, the world would have suffered staggering economic losses. Instead we chose deliberately to seek

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cooperative solutions, recognizing that the pervasive links among our economies made cooperation essential to our individual as well as our collective well-being. We must not forget that lesson.

Once again the world economy has been destabilized by a large oil price shock, almost equal in dollar amount to that of 1973-74. On an annual basis, the jump in oil prices will increase the import bill of the developed countries by almost $75 billion and of the developing countries by $15 billion. This action is disrupting international payments balances and adding greatly to the problems of containing inflation and reducing unemployment. Furthermore, uncertainty about the availability and price of energy seems likely to persist. Inflationary pressures, building up over a period of years, have become so virulent as clearly to require resolute, sustained, countermeasures. In this uncertain international economic environment, the prospects for world economic progress are less promising. And that is a particularly harsh prospect for the one-fifth of the world's population facing absolute poverty.

These problems are worldwide. They are shared in common, to varying degrees, by all our societies. They can be successfully overcome only through persistent national action, augmented by intensified international collaboration. And that means relinquishing a degree of autonomy in national action.

It is in this context that we must examine the present and future work of the IMF and the World Bank group. These two institutions provide the infrastructure for world cooperation in economic policy, in finance, and in development. The degree to which we support them represents the central measure of our willingness to support more effective global economic management.

Intensified collaboration is the course we must choose for the 1980's. It is therefore essential that the IMF and the World Bank group be strong enough to do the job—strong enough in authority, operations effectiveness, and resources. I propose, therefore, to outline my views on the future direction of policy in these two institutions and on the tools they will need to do the job.

International Monetary Fund

Financially, the Fund is in a strong position to face the new testing period that lies ahead. The supplementary financing facility has been activated and remains almost fully available. The quota increase scheduled to take effect next year will add a large and timely infusion of resources. The compensatory financing facility, which proved so valuable during the cyclical downturn of the mid-70's has recently been substantially liberalized and will provide an important element of security to primary producing nations. Furthermore, the IMF has revised its guidelines on conditionality so that it can foster orderly balance of payments adjustment in ways that meet the needs and circumstances of members.

Nonetheless, there is more to be done to assure the adequate utilization of the IMF's financial resources and to strengthen the Fund's capacity to manage the monetary system. Three areas deserve early attention.

First is surveillance. Under the amended articles, Fund surveillance—surveillance over members' general economic policies as well as exchange rate policies—is the centerpiece of international monetary cooperation. Without effective surveillance, there is no system. The Fund has moved cautiously and prudently in implementing its surveillance procedures. Bolder action is now required.

One possibility would be for the Fund to assess the performance of individual countries against an agreed global strategy for growth, adjustment and price stability.

Another possibility would be to provide that any nation with an exceptionally large payments imbalance—deficit or surplus—must submit for IMF review an analysis showing how it proposed to deal with that imbalance. Now, only those countries borrowing from the Fund have their adjustment programs subjected to such IMF scrutiny. Greater symmetry is needed.

We should also consider inviting the managing director to take the initiative more often in consulting members directly where he has concerns about the appropriateness of policy. Any such approaches must, of course, be fully in accordance with the fundamental principle of uniform treatment for all members. For its part, the United States welcomes and values the Fund's views and advice, and would see merit in a

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more active role on the part of the Managing Director in initiating consultations with members.

As a further step, we might now give serious consideration to the establishment of the Council, as successor to the Interim Committee, and give it a more specific and direct role in the surveillance process. There would be value in such a move, both substantively and symbolically, and I urge that each of us give fresh consideration to this idea.

A second area for improvement is that of international liquidity. There has been solid progress over the past 12 months in enlarging the role of the SDR in the monetary system. A more fundamental move, the establishment of a substitution account is now under consideration. If, working together, we can resolve the problems involved in setting up that account—and I am hopeful that with good will it will be possible to resolve them in due course—the result would represent an important new approach toward greater reliance on an international reserve asset and a more centrally managed international monetary system.

The third area in which it may be possible to strengthen the system and make the IMF more useful and influential is in the field of cooperation with the private financial markets. This is not a new idea. But the arguments in favor of it have become more compelling.

We all recognize that the private markets will, in the future as in the past, have to play by far the major role in channeling financing from surplus to deficit nations. Official institutions, including the IMF, play a vital role in this process, but it is essentially catalytic in nature.

We must ensure that the IMF is doing all it appropriately can and should do in order to ensure that private financing flows smoothly and efficiently. We should reexamine ways in which the Fund can encourage the availability of better information on international bank lending, with greater uniformity with respect to potential borrowers. This could facilitate the process without jeopardizing the IMF's close and confidential relationships with members. We should also explore ways of encouraging earlier recourse to the IMF by countries facing difficulty, in the interests of maintaining overall financial stability and avoiding the need for more severe adjustment measures at a later stage if problems are left unaddressed.

World Bank

The successful contribution by the Fund to the smooth operation of the world economy will help the World Bank to encourage longer term economic improvement in the developing world. Over the past 10 years we have called for a steady expansion in the scope of the Bank's activities and it has never failed to respond effectively. The Bank is now the largest single source of external finance and technical assistance for economic development and the primary exemplification of international cooperation to achieve social and economic advance.

It must continue to be so. As President McNamara pointedly reminded us, the goals we set and the choices we make today in this difficult area of economic policy will have a critical bearing on whether conditions in the world will be tolerable a generation from now. This is a weighty responsibility; it is one we cannot avoid addressing.

The size of the problem is graphically described in the second world development report, for which I offer my appreciation and congratulations. Over the next two decades, 750 million new job opportunities will have to be created in the developing world. The extent of success in this endeavor will determine how many people in the world are able to enjoy economic well-being, and any shortfall will determine how many are left to face conditions of absolute poverty at the beginning of the 21st century.

In this situation, capital will always be extremely scarce in relations to needs. It will be essential, therefore, that bank loans, IDA credits, and IFC investments should stimulate, to the maximum degree, mobilization of domestic savings in the developing countries and the flow of private capital from abroad. Specifically this means:

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- Greater emphasis on creating productive job opportunities in the rural areas, where poverty and underemployment are pervasive. Without more progress here, the food problem could become worse, population pressure will become more severe, and the flow of people to cities could become overwhelming.
- New approaches to job creation in cities and the provision of low-cost basic services to the urban poor.
- Investments in human capital through programs in education, health, and family planning.
- In all areas, a conscious and more effective program to reduce capital investment per job created, and to insure that in a fundamental economic sense investments pay for themselves. Only then will capital used today be recovered tomorrow to be invested for the benefit of others.
- New initiatives to encourage cofinancing.
- More ambitious efforts to expand production of energy fuels, including new applications for renewable energy technology. The quantum jump in the price of oil is exerting a sharply constraining effect on economic growth everywhere, with particularly harsh effects in the oil-importing developing countries. An increase in the availability of domestic energy supplies is necessary to increase the productivity of domestic labor and capital.

To move in this direction requires that the bank be able to expand the scope of its activities. We believe that the capital of the bank must be increased substantially, and for this reason, supported the resolution of the Executive Directors to that effect.

We also support a sixth replenishment of IDA, and look to the completion of the negotiations before the end of this year. In accordance with our legislative procedures, our action in both respects will involve the close cooperation of the U.S. Congress.

Private financial markets

Strengthening the capacity and effectiveness of the IMF and the World Bank is also necessary to enable private markets to function smoothly and effectively. The latest increase in oil prices will place new demands on these markets to move funds from surplus to deficit countries. The actions of the two Bretton Woods institutions serve to strengthen the adjustment process, economic prospects, and credit positions of borrowing countries—all of which is a necessary foundation on which private lending can take place on a sustainable basis. This process also emphasizes how the work of the two institutions reinforce each other.

More generally, a strengthened cooperative approach, looking toward a more orderly management of the world economy, provides a framework within which each nation can address common problems in a mutually supportive way. The United States recognizes its role in this system and will continue to act to carry out its national and international responsibilities.

United States progress and policies

Economic growth in the United States during the past 4 years has been strong, and has made a major contribution to world economic recovery. Output has increased by 22 percent in real terms. Thirteen million new jobs have been created. At the same time, our rapidly growing market has provided a major economic stimulus for other countries recovering from world recession. Most notably, this has benefitted the developing countries, which have increased their exports of manufactured goods to the United States much more rapidly than to other countries.

The United States is well aware of the important role of the dollar in the international monetary system. We are determined to maintain reasonable balance in our external accounts and to assure that the dollar is sound and stable. We have acted vigorously to meet that obligation, with policies to strengthen underlying economic conditions, and with forceful exchange market operations to counter market disruption.

The U.S. balance of payments has improved markedly. Our current account deficit will be reduced from $14 billion in 1978 to a few billion in 1979, despite an increase of $16 billion in the cost of oil imports.

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Next year, 1980, we expect a substantial current account surplus. Continued strong export performance, a rising surplus on services, slower import growth, and U.S. determination to respond forcefully to unwarranted exchange market pressures, all provide a firm basis for dollar stability and strength in the period ahead.

We have already achieved important progress in strengthening the dollar exchange rate. The dollar has declined in terms of some currencies, moved higher in terms of others and remained stable relative to most. Measured against the average of OECD currencies, the dollar is now about 5 percent above level prevailing last fall. From the viewpoint of the OPEC nations, in relation to the other currencies they use to purchase their imports, the dollar has increased about 8 percent on average from a year ago.

Notwithstanding the favorable changes in the value of the dollar measured in terms of these averages, the United States is determined to maintain exchange market stability for the dollar in terms of individual major currencies, such as the deutsche mark.

The United States also recognizes the necessity of solving its energy problem. We are making substantial progress. Since 1973 the amount of energy required to produce a unit of real output in the United States has dropped by 7½ percent, and in the industrial sector, it has dropped by 20 percent. The ratio of the increase in energy consumption to the increase in GNP has fallen by one-third since 1973. That performance compares favorably with other industrial countries. Household energy consumption has leveled off. Our transportation fleet is rapidly becoming more fuel efficient—the average miles per gallon for new cars rose from 13 in 1973 to 19 in 1979, and will rise to 27.5 by 1985.

More must, and will, be done. President Carter has announced a series of measures, both administrative and legislative, which will sharply improve the overall U.S. energy position. Phased decontrol of domestic crude oil prices by September 30, 1981, will reduce oil imports by an estimated 1.5 million barrels per day by 1990. In addition, immediate decontrol of heavy crude oil prices will stimulate increase in production estimated at 0.5 million barrels per day. Creation of an Energy Security Corporation will provide the resources to help finance private sector development of synthetic fuel. Major emphasis is also being placed on developing renewable sources of energy. When fully in place, our energy program will cut oil import requirements by 4 to 5 million barrels per day.

At the recent Tokyo summit, the United States agreed that from now through 1985, we would import no more than 8.5 million barrels per day of oil, the level that prevailed in 1977. The President established a lower goal, 8.2 million barrels per day, for 1979. We are firmly committed to meeting the import targets.

Inflation continues to be our country's most serious problem. It threatens our ability to achieve full employment, it impedes investment, and it impairs productivity. We are determined to bring inflation under control and regain price stability.

Our recent record is not satisfactory to us. Food and energy prices have temporarily driven U.S. price indices into the double digit range. Energy alone accounted for more than one-half the total rise in finished goods prices at the producer level in the latest 3-month period. In coming months this pressure will recede as the effects of recent OPEC price actions work their way fully through the economy. Food prices have moderated in the wake of good harvests.

Special factors aside, the inflation rate is still much too high and must be brought under control. This cannot be done quickly or easily. It can only be accomplished by a firm application of sound policies which deal with the economic fundamentals.

All major instruments of U.S. economic policy are being directed toward this task. Fiscal policy is directed toward restraint.

We have arrested the increase in Government outlays in real terms and tax receipts are rising. The Federal deficit has been reduced from 3 percent to 1 percent of GNP. The Federal Reserve is exercising monetary discipline and will continue to keep firm limits on the growth of money supply. Despite rapid increases in recent months, the increase in MI over the past year was held to 4.9 percent—less than half the increase in consumer prices. The Federal Reserve is committed to meeting its targets for limiting the rate of growth of money and credit.

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These fiscal and monetary policies are supported by price and pay policies that will help moderate inflationary forces. On September 28, President Carter announced a national accord with U.S. trade union leadership that provides for labor's involvement and cooperation on important national issues. The national accord confirms that top priority will be given to the war against inflation. It recognizes that the discipline essential to wring out inflation will mean a period of national austerity. As part of the accord, labor leadership agreed to participate in the voluntary program of wage and price restraint. The involvement and cooperation of labor—and of management—in developing and implementing policies to control inflation is critical for success, and this cooperation has now been strengthened. The national accord will add momentum to our comprehensive attack on inflation.

The United States intends to reinforce the foundation on which to achieve sustained growth with price stability. We are headed in the right direction and are determined to stay the course. We are also determined to work with the nations gathered here to strengthen the international economic system, both through our own actions and through support of the IMF and the World Bank.

Mr. Chairman, let me add a personal postscript. The curtain will soon fall on the decade of the seventies. It has been a turbulent period for the world's economy. Progress has fallen far short of our great hopes.

Facing, as we do, another period of major adjustment, we have heard few words of encouragement at these sessions. It is right that we should be realistic about our difficulties. It is right that we should not delude ourselves with false expectations. It is possible, however, as we begin to prepare the agenda for the 1980's, to see some cause for hope. In particular, we have not given in to the temptation to become self-centered. The institutions for international economic cooperation are alive and well. The IMF and World Bank are proving their resilience, rising to meet the challenges.

For its part, the United States is unequivocally dedicated to dealing effectively with its own inflation and energy problems. This is the single most important contribution we can make to our own economic health and that of the world community.

I assure you that we have the will, determination, and perseverance to succeed in this endeavor. You can count on it.

Developing Nations

Exhibit 72.—Remarks by Assistant Secretary Bergsten, November 7, 1978, before the Association of American Chambers of Commerce in Latin America, Rio de Janeiro, Brazil, entitled "Economic Relations Between the United States and Latin America"

Economic relations between the United States and Latin America in the late 1970's are governed by two basic realities, which will clearly continue into the decade ahead.

First, Latin America is part of the universe of developing countries. It continues to suffer from pockets of extreme poverty. It can still be buffeted by external events beyond its control. Hence it must still be viewed as part of the developing world.

Second, however, Latin America is a uniquely successful part of that developing world. Along with a few countries in the Far East and elsewhere, it has moved far ahead of the poor nations of Africa and South Asia. It has become a major partner and, indeed, competitor of the United States in world trade. Hence it must also now be seen as a key actor in the world economy, adopting a growing responsibility for the functioning of that economy—on which its own prosperity so heavily depends—and deserving of a seat at the table for all important international economic negotiations.

U.S. economic policy toward Latin America must therefore be seen in two lights: As part of our overall approach to the developing world, and as part of our evolving effort to work with the advanced developing countries, the ADC's, in ways which take full cognizance of their rapidly changing capabilities and in pursuit of mutual benefit for us and them. Today I will address this issue in terms of its three components:

- The impressive progress of Latin America, which sets it well beyond any other region in the developing world;

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- The efforts of the United States toward Latin America, as part of our policy toward the developing countries both in aggregate terms and as differentiated to respond to the evolving needs of this most advanced region;
- Possible future developments which might build on the successes to date and exploit still further the rich opportunities for constructive cooperation between the northern and southern halves of our hemisphere.

Latin America in the world economy

Latin America has become an important actor in the world economy. Its impressive development during the past two decades, while leaving many problems yet unsolved, has thrust it into the forefront of the entire developing world. As a result of their development, several Latin American nations—particularly Brazil, Mexico, Argentina, and Venezuela—now play a major and creative role in international trade and finance.

Latin America has outpaced all other developing regions in its rate of economic progress:

- Between 1965 and 1977, the gross domestic product of the region more than doubled in real terms to nearly $400 billion. This represents an annual growth rate of 6.1 percent—compared with 5.1 percent for all developing countries, and about 3.9 percent for the industrialized countries.
- During 1973-1977, the region grew at an average annual rate of nearly 5 percent, compared with only 2 percent for the OECD countries. It maintained impressive growth through the world recession, cushioning the impact of the recession on the industrialized countries including the United States.
- Real per capita GNP in the region has increased by more than half since 1965. It now stands at $1,100, as compared with a per capita GNP of $450 for the rest of the developing world.

This rapid progress has sharply increased the importance of the region to the United States, and strengthened our economic relations with it. U.S. exports of goods and services to Latin America reached $25 billion last year, five times more than in 1965. U.S. imports from Latin America totaled $21 billion in 1977, four times as much as in 1965. Latin America is a major supplier of materials to the United States, accounting for 40 percent or more of U.S. imports of several key products. About one-quarter of U.S. petroleum imports now come from Latin America—a figure that may well rise in the future.

U.S. financial relations with Latin America have also expanded greatly. Total U.S. direct investment in the region approaches $30 billion—about 80 percent of all U.S. investment in developing countries. U.S. bank lending to Latin America has also risen rapidly, and exceeded $42 billion at the end of 1977—21 percent of all U.S. bank lending abroad.

These trends clearly make Latin America part of a new "international middle class," together with a few other countries in the Far East and Middle East. The continent is of course far from being fully developed. Indeed, huge pockets of poverty remain even within the most advanced countries of the hemisphere. Income distribution needs improvement in many countries. A few of the smaller nations of the region are still at relatively low levels of development.

The United States recognizes and respects the diversity and individuality of the nations of Latin America. But the region as a whole enjoys living standards far higher than those of developing Africa and Asia. It has become a major factor in key trading and financial markets throughout the world. As a consequence, we see our economic relations with Latin America as the "cutting edge" for new modes of international cooperation between industrial and developing countries—with real benefits for all participants whether they come from above or below the Rio Grande.

Looking ahead, we expect that both the economies of the region, and United States-Latin American economic cooperation, will continue to grow rapidly. We are optimistic about the future of the region, and believe that its dynamic economic growth will continue to exceed that of most of the rest of the world.

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This will further strengthen Latin America's position in the world economy. It will increase the region's influence in international economic decision making. Its importance as an exporter of increasingly sophisticated manufactured goods seems likely to increase sharply, as it acquires a comparative advantage on world markets for products such as motor vehicles and computers. One need look no further than the changing composition of Brazilian exports—including the shipment of Volkswagens to Germany—to see what shifting comparative advantage will mean to Latin America in the years ahead.

The policies of the United States

As a result of all these changes, the countries of Latin America—and, indeed, a great many other developing nations—are clearly an integral part of the global economic system. They, like we, have a vital interest in the future of the international economy, in the continued operation of an open international trading and financial system, in maintaining stable international monetary arrangements, and in ensuring adequate rates of growth of global production. As a result, they have a deep interest in our policies on a whole host of issues—not just those sometimes characterized as "North/South."

Indeed, a cardinal tenet of the international economic policy of the United States is to take developing-country concerns into account in formulating all of our global economic approaches. Today's mutuality of interests reduces the usefulness of bloc approaches to relations between developed and developing nations—which have too often been characterized by reckless rhetoric instead of pragmatic progress. As President Carter concluded in a speech earlier this year in Caracas: "Real progress will come through specific actions designed to meet specific needs—not symbolic statements by the rich countries to salve our consciences, nor by developing countries to recall past injustices."

In short, North-South relations are far too important to be relegated to a separate niche, isolated from the mainstream of national policies in either industrialized or developing countries. We seek to integrate the needs and concerns of the developing countries into each aspect of our international economic policy—as we hope they will increasingly recognize our needs and concerns in their policies as well.

We believe that an effective economic relationship between industrialized and developing countries must, in fact, be based on the twin principles of shared responsibility by all and a right for all to full participation in international economic decisions. These two elements are central to our approach to the developing countries. We recognize that the degree of responsibility assumed by each country will depend on its stage of development. For the poorest developing countries, where extreme poverty is pervasive, we support increased concessional development assistance and preferential treatment in international trading arrangements. For ADC's, and particularly for many of the countries of Latin America, a relatively advanced stage of development implies a gradual phasing out of preferential treatment, the beginning of active participation in efforts to assist those countries in less fortunate circumstances, and growing collaboration in molding the evolution of the international economic system.

For its part, the United States is making a major contribution to the developing countries, both those which are more advanced and those which are poorer. In less than 2 years, I believe that the record of the Carter administration is truly outstanding in this regard:

We have engineered an impressive recovery of the U.S. economy, cutting our unemployment rate from over 8 percent to under 6 percent, thereby restoring growing markets for LDC exports and improving the climate for all types of assistance to them. We have pressed other key industrial countries to do likewise, with some notable successes.

We have strongly supported an expansion of international balance of payments financing via the Witteveen Facility at the International Monetary Fund, whose more than $10 billion can be used by developing as well as industrialized countries, whereas the previous administration

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proposed to limit such help to OECD countries via the so-called Kissinger safety net.

We have given our support to a further increase in IMF quotas and the first allocation of special drawing rights since 1972, which was opposed by our predecessors, both of which will provide further financial help for all countries.

We have supported a major capital increase and a steady rise in lending by the World Bank, which is now committing almost $9 billion annually in financial resources around the world including $2.3 billion to Latin America, in the year ending June 1978, whereas our predecessors had put a ceiling on the Bank's whole lending program.

We have supported a growing role for the World Bank, the regional development banks, and our own Overseas Private Investment Corporation in the search for energy throughout the developing world whereas the previous administration rejected such a role for the public sector.

We have dramatically expanded the financing available from our Export-Import Bank, some of whose major clients are also here in Latin America, whereas the previous administration had virtually closed down the Bank as an effective lubricant for international trade.

We have succeeded in getting worldwide agreement that the multilateral trade negotiations should be concluded by December 15 of this year, thereby opening up new markets for the exports of developing (as well as industrial) countries, after 3 years in which that effort went absolutely nowhere.

We have reversed the traditional U.S. position toward international commodity agreements, and are working hard both to negotiate agreements where price stabilization is technically feasible and to provide our share of the financial resources needed to make them work.

We have indicated our willingness to support, and participate in, a common fund which would be structured to enhance the aims of individual commodity agreements.

We have increased our budgetary allocations for foreign assistance from $5.1 billion in FY 1976 to $7.2 billion in the current year, including more than doubling our contributions to the multilateral development banks.

Of particular interest to Latin America, and digressing for a moment into the political arena, we have concluded an equitable treaty with the Government of Panama for orderly transfer of the canal.

We have made concrete progress in our efforts to include advanced developing nations in pragmatic, functional fora heretofore limited to industrialized nations to discuss mutual economic problems, such as the OECD Steel Committee and the International Arrangement on Export Credits.

These accomplishments have not come easily. Increased appropriations for foreign assistance compete with urgent domestic priorities and the need to cut Government spending to slow inflation. Our ability to resist protectionist pressures has been severely tested over the past 2 years, with unemployment still around 6 percent and a trade deficit of over $30 billion. The Panama Canal Treaty was unpopular with a large portion of the American public.

But we are convinced that these achievements are in the interest of the United States as well as Latin America. Indeed, President Carter has embraced each of them personally and adhered firmly to his policy principles, even when it would have been much easier to look the other way. We remain committed to the further expansion of economic cooperation between North and South, with appropriate participation by all nations—especially in the areas of trade and development finance.

Trade

Trade is probably the most important area of U.S. economic interaction with developing countries. Our focus here is threefold: Rejection of the many proposals to restrict U.S. imports from developing countries, most recently for copper; support for

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the multilateral trade negotiations (MTN), where we are working actively to significantly reduce tariff and nontariff barriers and to improve the rules governing international trade flows; continued preferential trading treatment in our market for the developing countries.

U.S. trade statistics provide the clearest indication of the openness of our markets. Our imports of manufactured goods from the developing countries have grown from $3 billion in 1970 to nearly $16 billion in 1977—an average annual growth rate of 25 percent, accelerating since 1975. Developing countries now supply 50 percent of our imports of consumer goods and 24 percent of all our manufactured imports.

At the same time, the trade area reveals most clearly the importance of policy interdependence among industrial and developing, particularly advanced developing, countries. *Our* ability to maintain an open trade policy depends increasingly on their willingness to gradually open their markets and play by the agreed international rules. The postwar history of Japan reveals the risks which are posed for an open world economy by a country which views itself as poor and dependent long after it has become a major force in world trade, and fails to take into account the repercussions on its own most vital interests of waiting too long to assume truly reciprocal obligations—such as opening its own markets to imports and eliminating export aids which are no longer needed. It is our strong hope that today's ADC's will not repeat this serious mistake.

In practice, this means an increasing acceptance by the more advanced developing countries of at least partial reciprocity in the multilateral trade negotiations. For example, they could accept a commitment to limit their government procurement practices which discriminate against foreign suppliers. They could follow the guidelines of the International Arrangement on Export Credits. They could significantly reduce their excessively high tariffs. In general, it means phasing out special treatment as development proceeds so that needier countries can benefit from such preferences more fully.

The acceptance of greater responsibility in trade relations is especially important in the use of government subsidies. One of our most important objectives in the MTN must be to reach an agreement on subsidies and countervailing duties, to avoid the growing use of such practices by many countries and retaliation against them by others:

We need to put a lid on the growing use of subsidies to spur export-led growth at the expense of other trading nations.

We need to broaden to more countries, and deepen in substance, the commitment previously accepted by most industrial nations not to use export subsidies.

We need to strengthen the present GATT provisions on dispute settlement to ensure that these rules are enforced effectively.

Subsidies can of course play an important role in national economic policy, and flexibility in the rules is needed for countries on different rungs of the development ladder. Fully developed countries should subscribe to all provisions of the agreement immediately, whereas developing countries should be accorded special and differential treatment. However, the code should provide for increased acceptance of its obligations by ADC's as their industries become internationally competitive, as well as acceptance from the outset of the principle that their subsidies should not hurt other countries. We fully recognize the evolutionary nature of this process, and hence accept that these obligations can be phased in over time rather than instituted all at once.

We have been working extremely closely with several ADC's—including Brazil—on this problem. Indeed, Brazil has played an active role in discussions on the subsidies code, and other aspects of the MTN, in ways which attempt both to defend the legitimate interests of developing countries and to strengthen the global trading system. We hope, and expect, that Brazil and other key developing countries will continue to make positive contributions in the closing stages of the negotiations.

Of course, a large volume of our trade with developing countries already enters the United States duty-free under the existing tariff schedule and generalized system of preferences (GSP)—which the United States adopted in large part due to the needs of

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Latin America, most of which was excluded from the extensive system of specialized tariff preferences offered by the European Community. The total value of GSP imports from developing countries in the first 6 months of 1978 was running at an annual rate of almost $5 billion, of which almost one-third was from Latin America. GSP duty-free imports rose an impressive 31 percent in January–June 1978 over the same period in 1977. In Latin America, particularly strong gains were made by Argentina (up 91 percent) and Brazil (up 56 percent).

Our approach to GSP is designed to assure that the greatest benefits are made available to those who need them most. When a particular product from a country eligible for GSP becomes competitive in the U.S. market, that product reverts to normal tariff treatment on the grounds that special help is no longer needed—and that its continuance would unfairly hamper less competitive countries from getting an opportunity to enter the market.

Development finance

Our global policy in the area of development finance is to expand the flow of resources to developing countries, on appropriate terms, to assist them in their efforts to reduce poverty and achieve self-sustaining growth. This approach suggests that countries should, as they progress, move gradually but deliberately from (1) concessional assistance as provided by AID and the soft-loan windows of the multilateral development banks (MDB's) to (2) the nonconcessional windows of the latter institutions and the private capital markets into (3) positions where they can assist their poor neighbors through various bilateral and multilateral assistance channels.

As you are aware, this shift is well underway for most of Latin America. The United States has now terminated its AID programs in Argentina, Brazil, Colombia, Chile, Ecuador, Uruguay, and Venezuela (and to Korea, Taiwan, and Malaysia). A few of these countries have already begun to mount their own foreign assistance efforts to help the poorer LDC's.

As official financing for the more advanced developing countries has declined, the U.S. capital market has become their major source of financing. Open access to such funds has thus become a crucial element in meeting their financing needs. We applaud the success of these countries in tapping this source of funding, which should continue to grow in importance.

For our part, the U.S. Government has taken numerous steps to assure continued access for borrowers in developing countries. Recently, our regulatory agencies have placed increased emphasis on the principle of diversification of cross-border risk—a sound principle with benefits for both borrowers and lenders. Further possibilities for new sources of finance, such as cofinancing with official institutions and tapping the institutional investor markets, seem promising as supplements to bank lending. We have appropriated billions of dollars of callable capital for the World Bank and the Inter-American Development Bank (IDB), and are negotiating sizable expansions of both, so that they can play a growing role of financial intermediation—especially for borrowers in Latin America, who obtained $4.3 billion from these institutions in the year ending June 1978.

The current negotions for replenishment of the IDB, which are in their final stages, reveal the growing collaboration between the United States and the ADC's of Latin America in financial matters. The ADC's which still borrow from the Bank—Argentina, Brazil, and Mexico—have indicated a willingness to limit their shares to enable the poorer countries of the hemisphere to increase theirs, and to increase their own contribution to the usable resources of the concessional lending window of the Bank. We have therefore indicated a willingness to increase sharply the U.S. contribution to the Bank's capital resources, and we expect the result to be a highly satisfactory basis for IDB lending for the next 4 years.

Similarly, we are sharply expanding the lending program of our Export-Import Bank—from only $700 million of direct loans in FY 1977 to about $3.6 billion in the current FY 1979. The primary purpose of the Bank is, of course, to promote U.S. exports. At the same time, however, it provides borrowing countries with terms which are not available in the private markets and thereby enhances their financial positions.

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Latin American countries are heavy users of Eximbank, having borrowed almost $1 billion from it during the past 12 months, and therefore benefit jointly with us from its sharply expanded lending program.

The area of development finance also embraces an important, if largely unsung, example of recently enhanced cooperation among industrialized and developing countries. For some years, the Group of 77—the caucus of the developing countries—had taken the position that they should be granted relief from their private debt burdens via generalized moratoria and reschedulings. In late 1977 and early 1978, however, an increasing number of developing countries—to their great credit—recognized that any such steps, or even serious discussions thereof, would severely jeopardize the increased access to private capital markets which has become so central to successful development in so many of them. Hence they quietly dropped their "demands" on this issue, scoring an important victory for reality over rhetoric and demonstrating the possibilities for pragmatic cooperation between North and South. Some of the major countries of Latin America played a key role in that change of positions.

Future directions

As the development process in Latin America and other developing regions moves forward, continued evolution in economic relations will be necessary. It is clear that the developing countries are going to play an increasing role in the world economy, as producers and exporters both of manufactured goods and of key commodities.

The World Bank projects exports of manufactures by the developing countries to continue growing at an annual rate, adjusted for inflation, of over 12 percent. This would bring their total exports in 1985 to around $110 billion in 1975 prices—only slightly less than the combined manufactured exports of the United States and Japan in 1975. The ADC's have represented the most dynamic component of the world economy for over a decade, and are likely to do so for at least the decade ahead as well.

The great benefits to the advanced developing countries that will result from this progress require that they make great efforts to support a more open world trading and financial system by moving their own policies in this direction. There are hopeful trends, but there are also dangers that some countries may resist such an opening. Such resistance could create severe problems for the international trade and financial system. It would certainly jeopardize the ability of the United States to demonstrate that cooperation is a two-way street, and thereby to maintain our support for such a system, and I am sure this is true of all industrialized countries. Such policy interdependence means that our ability to keep our markets open depends importantly on their cooperation in providing access to their markets, and in avoiding subsidized sales to ours.

Correspondingly, the continued progress of the ADC's will require still greater participation by them in international economic affairs. As I have indicated, the United States is already looking for ways in which such participation can be enhanced. We welcome the advent of these new economic powers, and assure them that there is room for them at the center of world economic arrangements.

The specific focus of such arrangements cannot yet be clearly seen. To the extent that both developed and developing countries continue to seek to liberalize their economic relations with the rest of the world, however, it is apparent that additional forms of cooperation will become both necessary and desirable:

In the critically important trade field, full participation and membership in the General Agreement on Tariffs and Trade (GATT) are central goals. It is anomalous that important developing countries—including some in Latin America—are not members of GATT. Full participation in other functional groups, such as the OECD Steel Committee and the International Arrangement on Export Credits, is also critical to our mutual discussion of these problems.

Increased interdependence between developing countries and the rest of the world economy will increase the need for consultation and information exchange about near-term trends in the world economy. We will have to give much thought to how best to carry out this process.

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We believe possibilities in the investment field are particularly interesting. As the old ideologies that have resulted in widely differing views of foreign investment erode, and are replaced by pragmatic desires to maximize the contribution of such investment to world development, we see considerably greater opportunities for cooperation—as has already been evidenced in the IMF/IBRD Development Committee. The advanced developing countries fully understand the benefits to both home and host countries in assuring that multinational corporations play a constructive role in the world economy, and are quite able to negotiate effectively with these firms in pursuit of their own national objectives. This new situation may enable us to move toward agreement on new, mutually acceptable "rules of the game" for international investment.

Conclusion

The international economic role of the developing countries, particularly the ADC's, cuts across the entire spectrum of U.S. international economic interests and relationships:

- They should be assured a larger role in the management of international economic relations.
- As they reap greater benefits from world trade, their trade practices should increasingly conform to the rules applying to major world economic actors.
- As their financial positions become more solid, the more rapidly growing developing countries should depend less upon concessional assistance so that increased resources can be made available to their less fortunate neighbors, and they should begin to contribute to those resource flows themselves.
- In sum, developing and industrial countries must work together more closely for the benefit of both the world economy and for successful pursuit of their own national objectives. Such increased participation will bring joint gains for all countries involved.

The United States has traditionally taken the lead in expanding the network of international economic cooperation. We remain deeply committed to this effort, and seek to work with as many developing countries as possible to that end.

Recently, the United States has again taken a leading role in policies of cooperation with the developing world. We pledge to continue to do so, and will try to tailor our approaches to the differing needs of different developing countries.

In return, we seek cooperation from the developing countries themselves. Some—the ADC's—already have much to offer, and must naturally be the focal point of current efforts to expand the bases of shared responsibility for the effective functioning of the world economy.

This is our basic approach to relations between the industrialized and developing countries, particularly those in Latin America. Its foundation is the dramatic progress of the developing world itself. Its goal is joint progress with mutual benefit. Its method is enhanced collaboration and partnership. Only with such close cooperation can we hope to achieve a peaceful, prosperous, and successful international economic order.

Exhibit 73.—Excerpts from statement by Assistant Secretary Bergsten, December 7, 1978, before the Subcommittee on International Development Institutions and Finance of the House Committee on Banking, Finance and Urban Affairs, entitled "United States Participation in the Multilateral Development Banks in 1979"

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Upcoming legislation for the MDB's

We thus sincerely believe that we can effectively pursue U.S. policy goals in the banks while avoiding any rise in budget costs. To demonstrate this, and before going into detail on prospective replenishments, I would like to take a few moments to present the outlines of possible administration requests for the MDB's over the next 3

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years. My objective is to provide an overall framework within which you can better judge the merit of our individual proposals.

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During the course of 1979, we will also be coming to the Congress—via this subcommittee and its counterpart in the Senate—for *authorization* of the latest replenishments: For both the capital and concessional lending window of the IDB, and for the concessional lending programs of the Asian Development Fund and African Development Fund. Unlike 1978, we will thus have both authorizing and appropriating legislation in 1979.

During 1979, we will also have to complete negotiations for two major MDB's which will not require legislation until later. For reasons to be explained later, agreement is needed early next year on increasing the capital of the World Bank although congressional authorization will not be needed until 1981 and appropriation until FY 1982 or even FY 1983. By late 1979, we also will need to reach agreement on the sixth replenishment of the International Development Association (IDA VI) as a basis for both authorizing and appropriating bills in 1980.

We, of course, do not know how these latter negotiations will turn out. If the arrearages can be dealt with this year, however, it appears that the administration's request for the MDB's in FY 1981 would fall to the range of $2.5–$2.6 billion—a drop of 25–30 percent from the levels requested in FY 1979 and FY 1980, because of the 4-year plateau in current contributions on which we are now resting.

For FY 1982–84, the request can be expected to settle on a new plateau somewhere around $4 billion, depending primarily on the size of any general capital increase for the World Bank. However, the paid-in amounts would be no higher than for FY 1978–81 because all or most of the GCI will be financed by callable capital. Even in terms of budget authority, such an outcome would imply that the administration's request for the MDB's would have grown only by 7 to 9 percent per annum in nominal terms from FY 1978, when the request was $2.6 billion, to FY 1984; this growth rate is virtually nil in real terms. Excluding callable capital, the growth rate for paid-in amounts from FY 1978 through FY 1984 would be under 2 percent in nominal terms—a sharp decline in real terms. The program is thus fully consistent with the stringent requirements of our own budgetary situation, while permitting significant continued growth of the lending of the banks.

This, then, is the overall MDB agenda as we see it, and on which we seek your views. Let me turn now to the specific issues of greatest immediacy.

The Inter-American Development Bank (IDB)

The impressive development of most of Latin America has moved it far ahead of the poor regions of Africa and South Asia. Economic progress is visible on a broad spectrum of indicators—growth rates, international trade, investment, and GNP. However, Latin America still suffers from many of the problems of the developing world—pockets of poverty even within the more advanced countries, low levels of development in some countries, and inadequate capital, to mention a few.

These considerations, along with concerns mentioned previously by this subcommittee and others in the Congress, have governed our approach to the latest replenishment of the IDB. We have had a series of meetings since April of this year with other member countries concerning the Bank's lending program for 1979–82. A general understanding has now emerged which has substantial advantages for the United States: Increased emphasis on lending to poor countries and to poor people in all recipient countries, increased burden-sharing by both developed and developing countries, and reduced paid-in contributions by the United States.

The *lending program* of the Bank will undergo a significant restructuring as a result of this replenishment negotiation, based on the principle of graduation as economic conditions warrant. Indeed, three clear stages of graduation are recognized in this restructuring.

First, a number of countries have progressed sufficiently so that they no longer need to borrow at all from the concessional window of the Bank, the Fund for Special Operations (FSO).

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Due to this impressive extent to which Latin American countries no longer need concessional resources, the annual size of the FSO replenishment can be smaller than the last replenishment. We are proud of the fact that this is one foreign assistance program which, because of the economic progress of its recipient countries, can be—indeed, by agreement should be—allowed to decline.

Moreover, the FSO's concessional funds will be devoted increasingly to the poorest and least developed countries in the hemisphere. * * * All countries outside this poorest and least developed group, which will continue to tap the FSO at all, agree to limit their borrowing from it to projects which directly benefit poor people within their borders. Thus, under the terms of the proposed replenishment, scarce concessional funds would be focused much more sharply on both the poorest countries and on the poorest people than has been the case in the past.

The second graduation step is that, in the capital window of the Bank, the largest and more prosperous Latin countries—Argentina, Brazil, and Mexico—would receive no increase in borrowing in light of their widespread access to private capital markets. Thus they will sharply reduce their percentage share of IDB lending, although retaining sizable amounts in absolute terms. The Bank will help them adjust to this change by arranging an increased amount of cofinancing for them with IDB projects, improving still further their access to private capital.

This constructive step by the advanced developing countries (ADC's) of Latin America permits the third phase of graduation. In it, the poorer countries will attain a 5-percent annual increase in their real rate of borrowing to help cushion their moving from primary reliance on the concessional funds of the FSO to the harder lending terms of the capital window. * * *

Another important feature of the replenishment agreement is that the Bank will take action to better target its hard window loans to poorer people in recipient countries. It is agreed that 50 percent of all lending from the IDB during the replenishment period would directly benefit the poorest people in recipient countries, compared with 37 percent at present. This is a major step forward in achieving a key goal shared by the administration and the Congress: targeting MDB lending on the poorest people in recipient countries.

More equitable burden-sharing by both developed and developing countries is a major objective for the United States in all of the multilateral development banks. In the current IDB replenishment, we have made major progress in achieving that objective:

- The developed nonregional members of the Bank (Europe and Japan) will bring their cumulative share of IDB capital from 4.4 percent to 7.2 percent, by taking 11 percent of this replenishment.
- Two-thirds of the paid-in capital subscriptions of Latin American and Caribbean members will be provided on a fully convertible basis; in previous replenishments, only one-half was in convertible currencies.
- The ADC's of Latin America—Argentina, Brazil, and Mexico—will triple the convertible proportion of their contributions to the Fund for Special Operations, from 25 percent to the equivalent of 75 percent.

These major changes in the IDB lending program and burden-sharing arrangements will permit a reduction in U.S. paid-in contributions which is fully consistent with the Bank's continuing to play its proper role in development in Latin America. * * *

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In our view, this package meets a number of key U.S. policy goals and deserves strong support: It increases lending to the poorest people and countries of Latin America, with reduced budget costs for the United States and with larger shares taken by other donors. The Board of Governors of the Bank will meet before the end of the year to approve the proposed replenishment. Any pledge by the United States would, of course, be made subsequent to the necessary legislative actions, and we would return to Congress for authorization and appropriation early next year.

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The World Bank

The World Bank group is the most important source of development resources in the world. In FY 1978, the IBRD, IDA, and the International Finance Corporation (IFC) combined committed over $9 billion to the world's developing nations. Two-thirds was from the IBRD alone. * * *

The World Bank has been an invaluable instrument for promoting equitable burden-sharing of development assistance with other donors, sustainable levels of private financial flows, efficiency in the use of resources, international cooperation, and an open world economy. These are all objectives that the United States itself has sought to achieve. And the price has been right: Since 1947, the IBRD has made loans totaling $45 billion, yet the United States has paid in only $840 million—less than 2 percent of the loan total. Most IBRD lending is financed by bond sales, largely in private capital markets.

If the IBRD is to maintain its vital place in the world economy, a general capital increase will be required in the 1980's. Agreement on such an increase must be reached soon, although the capital would not start to be needed until FY 1982 or FY 1983, or else the IBRD would have to trim its lending plans almost immediately to avoid a sharp falloff in future years.

Failure to approve a GCI would mean that Bank lending would level off at the present rate of about $6 billion annually, and decline in real terms. The results would be extremely negative for world development prospects, for overall North-South relations, and for a wide range of U.S. interests. It is in the interest of the United States to support continued growth and development in the LDC's, and one of the most cost-effective ways to do so is a major increase in the IBRD's capital.

As a result, President Carter announced U.S. support for a GCI at the annual meeting of the Board of Governors of the Bank and Fund this past September—as did all participants in the Bonn summit last July. Most of the discussion has centered on proposals for an increase of $30–$40 billion. This would provide the Bank with lending capability for 5 to 6 additional years, until the late 1980's.

The U.S. share, again in keeping with the Sense of the Congress resolution in the FY 1979 appropriation bill, would be no more than 24 percent—perhaps less, if other countries are willing to raise their shares as may well be the case. Hence the amount of U.S. contribution would range between $7.2 billion and $9.6 billion, to be made available over a 5- or 6-year period.

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IDA

Talks are at a much earlier stage on the sixth replenishment of the International Development Association (IDA VI), which provides concessional assistance for the World Bank group. About 90 percent of IDA loans go to the poorest countries, with GNP per capita below $295. Country contributions to IDA are paid in 3-year cycles, and the current cycle will be complete in June 1980.

At the Bonn summit, the President and his colleagues pledged support for a replenishment of IDA that would allow it to increase its lending in real terms over the 3 years beginning July 1980. At the first replenishment meeting on December 11, we will primarily be seeking to learn the views of other countries on the proper size of IDA VI, and stressing the need for further reductions in the U.S. share. We will consult closely with the Congress before adopting any positions on the size or U.S. share of the IDA VI replenishment.

The African Development Bank

Finally, I would like to mention briefly the opening of membership in the African Development Bank (AFDB) to nonregional members.

This Bank is unique among the MDB's in that its membership has been drawn entirely from regional developing nations since its establishment in 1964. It has no members from the ranks of the industrial countries. The Bank makes loans on nonconcessional terms. Its subscribed capital is currently $957 million and its cumulative loans total $662 million.

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Although the Bank's membership is entirely African, it has established a concessional lending affiliate—the African Development Fund—in which industrial nations participate. The United States and other industrial countries have made $450 million available for lending on concessional terms to some of the world's poorest countries in Africa, and for projects designed to benefit some of the world's most disadvantaged people.

At the May 1978 annual meeting, the Governors of the Bank authorized the beginning of negotiations on non-African membership in the Bank itself. The administration strongly supports the efforts of the African Development Bank to expand its base of resources. Although it is too early to develop a specific position on U.S. participation in the Bank, we have participated positively and constructively in discussions with other non-African countries considering membership.

U.S. membership in the African Development Bank would help promote our relations with the countries of Africa. The crucial importance of Africa to the global management of international political and economic affairs is now well recognized. Our support for the African Development Fund reflects the strong commitment which the administration and Congress share in supporting the aspirations of African peoples for a better life. We would welcome your views on possible U.S. participation in the Bank as the administration develops a more specific position on this issue.

Conclusion

Mr. Chairman, in this testimony I have attempted to lay out the current thinking of the administration toward the multilateral development banks—including both overall U.S. participation levels and the U.S. role in the specific replenishment discussions which are current.

We now seek your reactions, and those of your colleagues in the Congress. I believe that we have made every effort to proceed on these matters only on the basis of the fullest possible consultations with the Congress, and I assure you that we will continue that approach. We deeply appreciate the opportunity to participate in these hearings, and look forward to working with you actively during the 96th Congress.

Exhibit 74.—Excerpts from statement of Secretary Blumenthal, March 14, 1979, before the Subcommittee on Foreign Operations of the House Committee on Appropriations, regarding the administration's appropriations request for the multilateral development banks

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This year we are requesting budget authority of $3.6 billion for the development banks. This consists of two parts: $1,842 million for paid-in capital subscriptions and for contributions to the concessional windows of the banks, which will eventually result in expenditures; and $1,782 million for callable capital subscriptions to the banks, which will not result in actual expenditures.

The request breaks down as follows:

- $1,026 million for U.S. subscriptions to the World Bank's capital. Ten percent of this amount, or $102.6 million, would be paid in. With this subscription, and those of other member countries, the Bank is able to borrow on private markets and relend the funds for development assistance projects at market rates of interest. The Bank has never had a default on its loans and earns money each year.
- $1,092 million for U.S. contributions to the fourth and fifth replenishments of the International Development Association. IDA is the concessional loan facility of the World Bank. It lends money only to the poorest countries of the world. Of this total, $800 million is for this year's installment to IDA V, and $292 million is needed to complete the final installment of the U.S. contribution to the fourth replenishment, which was negotiated by the previous administration. This year's total IDA request is $166 million less than what Congress actually appropriated for this institution last year.

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- $33.4 million for the third and final installment of U.S. contributions to the International Finance Corporation, the World Bank affiliate that encourages the growth of productive private enterprise in developing countries.
- $687 million for the first installment of the U.S. subscription to the capital of the Inter-American Development Bank. Of this amount, 7.5 percent, or $51.5 million, is paid in. The Bank is a primary source of development lending in the hemisphere, and the United States is its leading shareholder.
- $325 million for U.S. contributions to the Fund for Special Operations of the IDB, the Bank's soft-loan window. $175 million is for the first of four annual installments to the new replenishment, each of which calls for a lower U.S. contribution than was pledged to the previous replenishment. The remaining $150 million is for the final part of our contribution to the prior replenishment, which was negotiated by the previous administration.
- $248 million for subscriptions to the capital of the Asian Development Bank. Ten percent, or $24.8 million, of this subscription will be paid in. This Bank has established an excellent record, and Japan has taken the lead in providing for its financing. Furthermore, European members have increased their proportionate share in providing funds.
- $171 million for U.S. contributions to the Asian Development Fund, the soft-loan window of the Asian Development Bank. $111 million is for the first installment of our contribution to the new replenishment, and $60 million is for the final installment of our contribution to the present replenishment, which was negotiated in 1975.
- $42 million for the first of three annual installments to the African Development Fund. This request will enable the United States to provide a reasonable share of funding for concessional lending to the poorest African countries. It reflects our objective of taking a more active role in encouraging economic and social development in Africa.

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* * * Let me tell you why I believe it is necessary and why it would be well spent.

First, helping the developing countries through participation in the banks advances important U.S. foreign policy and security interests. * * *

The United States has a great deal at stake in these countries. As recent events have clearly demonstrated, some occupy strategic geographic positions, and possibilities exist for unrest and conflict, which could carry dangers for many countries, including the United States. Furthermore, we need the cooperation of the developing world if we are to achieve such objectives as: halting the proliferation of nuclear weapons, limiting conventional armaments, combating international terrorism, suppressing international drug traffic, controlling illegal migration, promoting human rights, and protecting the global environment.

Our economic interests in the developing world are large and growing. As a group, these countries were a market for 30 percent of our exports in 1977, including $6.7 billion in agricultural commodities. They were the source for 24 percent of our imports in 1977, including tin, bauxite, rubber, manganese, and other critically needed raw materials. To ignore the developing countries is to ignore our own interests.

Second, we derive significant economic and financial benefits from the activities of the multilateral banks, which more than offset the budgetary burden of our contributions. In short, we earn a good return on our investment.

These direct financial and economic benefits include contracts awarded to U.S. firms resulting from development projects financed by the banks, the purchase of other goods and services in this country derived from bank activities, and interest paid to U.S. holders of bank bonds. On a cumulative basis, the banks have returned in these kinds of benefits substantially more than the amounts which have been paid in by the U.S. Government. Thus our contributions to the banks have not been a problem for the balance of payments or a source of trouble for the dollar. Indeed, they have provided benefits for the U.S. economy in terms of jobs and our economic growth.

Looked at more broadly, the multilateral development banks have played a very constructive role in sustaining a smoothly functioning and growing world economy which in turn has helped our trade and employment. They are a central part of the

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system for economic cooperation which the United States worked hard to establish after World War II and which we must continue to support strongly today. * * *

Third, the banks have been effective instruments for promoting economic and social development and thus are contributing to a more tolerable world environment for this and coming generations.

Essentially these institutions apply banking principles to the achievement of development purposes. In this they are unique instruments in the annals of economic change, and they work. The projects they finance are soundly conceived, carefully supervised, and well executed. Of course there have been exceptions, but they are comparatively few and the average quality has been high indeed.

One of the principal U.S. objectives in the banks is to encourage and expand the use of resources to assist the poor—not to finance a welfare program, but to raise productivity and increase employment opportunities. This requires the financing of the right mixture of projects to enlarge basic infrastructure, raise agricultural productivity, provide the basis for expanded employment in urban areas, and provide the foundation for the extension of essential social services.

The World Bank has been a leader in the effort to reach the poor, and progress is continuing. During the Bank's last fiscal year, 31 IDA projects, amounting to $867 million, were approved for rural development lending alone, with benefits going mostly to small farmers, tenants, and landless laborers. Emphasis is being placed on helping the urban poor through projects which provide sites and services for housing and through the encouragement of labor-intensive industries.

In the Inter-American Development Bank, the recently negotiated replenishment agreement explicitly provides that 50 percent of all Bank lending—conventional and concessional—will benefit low-income groups. In addition, the agreement requires that concessional resources from the Fund for Special Operations be effectively targeted at the poorest countries and the poorest people of the hemisphere.

While we have devoted a great deal of effort to encourage movement in this direction, we recognize that the banks must maintain a balanced approach to growth and development. Lending for transportation, communications, and electric power will continue to have high priority. Infrastructure and basic needs projects depend on each other.

We strongly support and give high priority to the expansion of Bank lending for energy development. In response to a request made at the Bonn summit meeting, the World Bank explored new approaches to help solve the growing energy problems of developing countries and proposed an expanded lending program to do this. The United States has endorsed the general provisions of that program, including Bank financing for geological and geophysical surveys and exploratory drilling, and an acceleration in lending for projects to develop and produce gas and oil. By 1983, the World Bank group expects to be lending $1.5 billion a year for this program, which would amount to more than 10 percent of its total lending. Over the next few years, the Inter-American Development Bank will be devoting a large proportion of its lending to help finance hydroelectric, geothermal, and other aspects of energy development in Latin America, and the Asian Development Bank has also embarked on a large lending program to finance the production of primary energy fuels. These Bank funds, moreover, will facilitate additional private investment in this critical area, thus helping to meet urgent requirements in the developing countries, and improving the oil supply and demand balance for the world as a whole.

Fourth, the banks are an unusually effective means for sharing the development assistance burden among the better-off countries.

Currently the United States provides one-fourth of the total funding requirements for these institutions, while other countries provide three-fourths. In contrast, the United States, 25 years ago, provided about two-thirds of total foreign economic assistance. Countries that once received assistance are now major sources of assistance, and this encouraging process continues today.

Consequently, our participation in the multilateral development banks has proven to be increasingly cost effective. Our foreign assistance dollar is stretched much further; it has greater impact and does more good for us and the developing countries as a result of our participation in the banks. These substantial benefits, however, require that the United States contribute its fair share of total resources. * * *

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Direct budgetary costs are even more greatly reduced by the banks' extensive use of callable capital for subscribing to new shares. This type of capital is not paid in to the banks. In the case of the United States, it never leaves the Treasury Department and does not result in any budgetary outlay. These subscriptions, however, serve as backing that enables the banks to borrow in the world's private capital markets. Callable capital would result in a budgetary outlay only in the event it were needed to cover a bank default on an obligation to bondholders. Such a call has never taken place in the past. In view of the banks' excellent financial record, their paid-in capital, and their large reserves from past earnings, the possibility of a call taking place in the future is remote.

Under typical capital replenishment arrangements, 9 out of 10 dollars for conventional lending are raised by the banks in this way, enabling us to achieve very large budgetary savings without restricting the flow of needed resources to developing countries. In the case of the World Bank, total U.S. paid-in capital contributions of $884 million have generated more than $45 billion of lending, a leverage factor of 50 to 1. Moreover, the value of our shares is not only still intact, but it has been increased as a result of past earnings.

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Have domestic social programs suffered as a result of our foreign assistance program? I do not believe so. Only one-fourth of 1 percent of our gross national product goes for foreign economic assistance, including our participation in the multilateral development banks. This figure has declined in recent years and is now lower than the corresponding GNP shares for 12 of the 17 countries in the Development Assistance Committee of the OECD.

On the other hand, U.S. budgetary expenditures for domestic social programs have risen rapidly over the past decade. In 1965, expenditures for these programs amounted to $6 for each dollar of foreign aid. By 1969, this multiple had risen to $18 and by 1979 to $46. Funding for foreign economic assistance has not taken place at the expense of domestic social priorities. The question is not whether the United States can afford to fund foreign assistance programs, but rather can we afford not to. The answer clearly is "No."

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I would like to conclude, Mr. Chairman, by asking that we step back for a moment and consider these institutions from still another vantage point. The evidence shows that they are one of the great success stories of the entire postwar period, stretching from Bretton Woods to the present. Even now they are continuing to improve on this impressive record. They give us good value for our money, their net impact on the budget is small, and they bring substantial economic and political benefits. I ask for your support in making it possible for this good work to continue.

Exhibit 75.—Remarks by Assistant Secretary Bergsten, March 15, 1979, before the United States-Mexico Chamber of Commerce, Washington, D.C., entitled "United States-Mexican Trade Relations: A Framework for the Future"

One month ago today, President Carter and President Lopez Portillo met in Mexico City to discuss major issues of importance to both Mexico and the United States. Trade was one of the principal topics on their agenda. Its inclusion was fitting testimony to the rapidly growing importance of trade between the United States and Mexico, and to the need for our two countries to work together closely to foster the continued development of trade to our mutual benefit. This, therefore, is a particularly opportune moment to continue the constructive dialog and to examine the structural framework within which trade can flourish, and within which potential trade problems can be managed.

Trade between the United States and Mexico plainly is of great importance to both countries. Our geographical proximity and each country's ability to produce goods needed by the other strongly suggest that the importance of our bilateral trade will continue to grow. At the same time, the critical trade issues facing us must be viewed

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in the broader perspective of the global trading system and of the global economic interests of both countries.

A major factor in this perspective is that the United States is of course the world's largest trading country, with far-reaching responsibilities for promoting the maintenance and further liberalization of the world trading system. Another is that Mexico, to its credit, has over the past two decades clearly emerged as a major participant in the international economic system. It is, in fact, one of a small group of countries we now refer to as advanced developing countries, or ADC's—countries which have achieved intermediate levels of economic development and which clearly have the potential to move into the ranks of major world economic powers.

An indicator of Mexico's growing status is the performance of its exports in this decade. Since 1970, its total exports increased from $1.4 billion to about $6 billion in 1978, an average annual growth rate of 21 percent. Moreover, Mexico enjoys some of the brightest prospects of any country for future expansion of exports and of its domestic economy.

We welcome the enhanced role Mexico is assuming in the global economy. Its new position will lay the groundwork for expanded and productive Mexican relations with the United States and other countries. We reaffirm that there is room for Mexico, as a result of its dynamic development and outstanding prospects, among the major industrial and trading nations of the world. Mexico is, of course, considering how it can most effectively translate its augmented position in the world economy into the greatest possible benefits for its own economic development. In the trade area, it is now assessing whether to take two important steps to improve its prospects—membership in the General Agreement on Tariffs and Trade, and full participation in the pending conclusion of the multilateral trade negotiations in Geneva. Mexico has decided to initiate negotiations for possible accession to the GATT, and is participating fully in the MTN negotiations. If Mexico is to play its rightful role in the global trading system, and if we are to assure maximum cooperation between the United States and Mexico in the trade area in the years ahead, Mexican GATT accession and full Mexican participation in important MTN agreements, such as the code on subsidies and countervailing duties, could make an important contribution.

United States-Mexican trade

Bilateral trade between the United States and Mexico has multiplied in this decade and has assumed greater importance for both countries. In 1977, such trade reached $9.2 billion, compared with $2.8 billion in 1971. Mexico is already the United States' fifth largest trade partner. The United States supplied 60 percent of Mexico's imports in 1977, and took 62 percent of its total exports. Bilateral trade flows could well reach $30–$35 billion by the mid-1980's—a remarkable increase over such a short period of time.

Mexican exports of both manufactured and agricultural goods have figured importantly in the total trade picture. In 1977, fully $2.2 billion of U.S. imports from Mexico (47 percent) were industrial products. An additional billion dollars in imports (21 percent) were agricultural products, an important source of income for Mexico. We expect that both these categories of imports will continue to show sizable increases. We see Mexico as a trading partner of growing stature, a true partner with whom we will develop a full range of trade relations that will strengthen economic growth on both sides of the border.

To be sure, Mexican energy exports to the United States are also likely to grow. As President Carter has emphasized, the development of Mexico's energy resources is a decision which will be made by Mexico based on its own priorities and needs. Our two Presidents had fruitful discussions last month on a range of United States-Mexican energy issues. They agreed to continue bilateral talks on a number of these issues, including possible exports of Mexican natural gas to the United States. I am confident that, based on those discussions, we will now be able to make progress toward an accord which will fulfill important objectives of both countries.

We welcome indications that Mexico is about to embark on an ambitious new industrial development program. We support its goals of encouraging rapid economic growth, decentralizing industrial development, encouraging investment in strategic

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sectors of the economy, and spurring the development of small industries. Most importantly, the program should greatly increase employment opportunities in Mexico—which is of great interest to the United States.

Such a program will certainly encourage—and, indeed, will in part depend on—increased exports, both to the United States and other markets. At the same time, it will stimulate demand for imports, which are likely to come largely from the United States. We welcome the prospects of greater bilateral trade, and remain committed to maintaining the greatest access possible to our market for Mexico. Our success in carrying out this policy thus far can be measured by several indicators:

- U.S. imports of Mexican manufactured goods more than quadrupled from 1971 to 1977, expanding from $492 million to $2.2 billion;
- Duty-free imports from Mexico into the United States under the generalized system of preferences (GSP) have grown from $253 million in 1976 to $458 million in 1978, a jump of 81 percent in only 3 years and considerably above the 65-percent increase in all GSP imports over the same period;
- Mexican imports under sections 806.30 and 807 of the U.S. Tariff Schedules have increased from $270 million in 1971 to $1.15 billion in 1977, with $525 million of the latter accounted for by Mexican value added. These sections provide for reduced payment of duty on articles imported from the United States, assembled or manufactured in Mexico, and reexported to the United States;
- Between 1975 and 1977, Mexico's trade deficit with the United States declined from $2.1 billion to $200 million, and our projections indicate that the balance may soon be in Mexico's favor.

The United States has consistently resisted demands for new import restrictions. President Carter in 1978 rejected five recommendations to restrict imports, while the relief granted in three other cases affected an insignificant amount of trade with Mexico—only about $1.5 million. We intend to continue this policy to benefit Mexico, as well as other developing countries, as much as possible through access to our markets. In the MTN, for example, we have offered to cut tariffs on a wide range of products of interest to Mexico.

Potential problems

The increase envisaged in United States-Mexican trade, however, is not without some risk. We have maintained our record of openness to imports despite strong domestic pressures to place limits on them. Those products which Mexico is most able to export to the United States, including certain agricultural goods and labor-intensive manufactured goods, are often the subject of proposals for restrictions in the United States.

Increasingly, the ability of the United States—and other industrial countries—to maintain its commitment to trade liberalization depends critically on the willingness of other countries in turn to open their markets to imports and to avoid subsidies on their exports. Clearly, it is in the interest of Mexico and other ADC's to help maintain the momentum of liberalization from which they have so greatly benefited.

In the past, Mexico has discouraged imports by means of a complex system of import licensing. We are encouraged by Mexico's recent shift in emphasis from licensing requirements to tariffs. Since it began to reduce its licensing requirements, Mexico has removed over 5,000 categories, or nearly 70 percent of the total, from the import permit list. We applaud these initiatives and hope that Mexico may soon begin to reduce its sizable tariffs and eliminate other restrictive requirements as well. We believe that such steps would indeed abet the country's future economic development.

The GATT

The importance of these issues suggests strongly that it would be beneficial for a nascent industrial power like Mexico to assume membership in the body which regulates and fosters world trade—the GATT. Over 80 countries, including virtually all the world's important trading nations, are members. Several more have expressed

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their intention to join. We would welcome Mexican membership in the GATT and believe it would further United States-Mexican trade relations.

The GATT system has permitted rapid expansion in world trade since its inception over 30 years ago. The management of our bilateral trade problems, and assurance of Mexican access to world markets, can be achieved most effectively through the GATT framework. We see a number of marked advantages for Mexico in GATT membership:

Mexico's access to foreign markets will enjoy a much greater degree of security. Mexico already enjoys substantial security in the U.S. market. But if it is to diversify its exports and its markets, Mexico needs assurances of security of access on a multilateral basis;

Mexico would have access to the dispute-settlement procedures of GATT in case of disagreements. If necessary, impartial multilateral panels can be called upon to settle differences. Such multilateral review can entail greater objectivity and flexibility, as well as greater bargaining leverage, than may be available bilaterally;

Mexico would be in a position to be a strong advocate of its own interests—and the interests of developing countries generally—in GATT deliberations concerning future international trading rules; and

Mexico will stand to gain much more from the MTN if it joins the GATT. Other nations will be able to make greater concessions to Mexico if they have assurances that Mexico will participate in and contribute to the global trading system.

GATT membership plainly would benefit Mexico. As one of the leading trading countries of the world, Mexico's participation in the major world trading organization would also enable it to play a leadership role in trade policy among, and on behalf of, developing countries as a group.

To be sure, GATT membership will entail Mexico's assumption of greater responsibilities and obligations. Fears that membership will place intolerable burdens on Mexico, however, or that it will interfere with Mexico's industrial development plans, would seem to be unfounded:

- Accession to the GATT is achieved through negotiations between the acceding country and GATT members. The acceding country thus can freely negotiate a gradual schedule of increasing obligations, and need not bind itself immediately to any international obligations it will not or cannot undertake;
- GATT Article XVIII provides special provisions for developing countries to ensure that they can protect their developing infant industries. These provisions have been strengthened in the current MTN negotiations;
- The GATT contains special provisions permitting developing countries to exercise safeguards for balance of payments reasons. These rules too have been improved in the MTN;
- The presence of dozens of developing countries already in the GATT, many of which have experienced dynamic export growth and have been fully able to pursue trade policies which fostered their development, represents empirical evidence that membership does not place intolerable burdens on developing countries; and, finally,
- While developing countries are expected to contribute to trade liberalization in the MTN, these contributions are freely negotiated and are to be consistent with each country's development, trade, and financial needs. The reciprocity which industrial countries are according each other is neither expected nor sought from developing countries.

The case thus seems clear. Mexico's world role points to its membership in GATT. Other countries would welcome it. Mexico's own interests would seem to require it. We hope Mexico will choose this course in the near future.

The MTN subsidy code

Full Mexican participation in the MTN package about to be concluded in Geneva is also important. Mexico has taken an energetic role in MTN discussions, including

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thorough talks with the United States on tariff reductions. We think that Mexico acted wisely in choosing to work actively in the MTN, and that it should be recognized for its readiness to engage in extensive MTN discussions.

We believe these talks have been useful to clarify differences in perspective and lay the groundwork for ultimate agreement. But time is short—the United States is now wrapping up its negotiations, and the administration intends to present a final MTN package to Congress in April. As our two Presidents agreed, it is therefore essential that the United States and Mexico rapidly conclude a tariff agreement. We have offered substantial cuts which will benefit Mexico. We hope Mexico will join in the MTN efforts to liberalize trade by making contributions consistent with its development level.

One of the most important components of the MTN is a code regulating the use of subsidies and countervailing duties (CVD's). Mexican participation in the code is of great significance to ensure the smooth future development of United States-Mexican trade relations. We believe that Mexico has much to gain by participating in the subsidies code:

- Mexican exports to the United States that benefit from subsidies would be protected from the threat of automatic countervailing duties. For countries which assume obligations under the code, such products could not be subjected to CVD's unless injury is demonstrated—but no such test will apply for countries which stay outside the code.
- Mexican participation would help encourage the widest possible participation in the code. With such broad participation, exporting countries will have greater assurances that their exports will not have to compete in third markets with products subsidized by other countries—an important consideration for Mexico, which subsidizes much less than some of its competitors among the developing countries.

The United States is prepared to make an important contribution to the subsidies code—the administration has recommended to Congress that an injury test be incorporated into U.S. law. But it should be noted that nations which do not accept the obligations of the code, whether industrial or developing, will not receive its benefits. In particular, the United States cannot apply the injury test to subsidized exports from those nations that fail to sign the code and assume appropriate obligations. In the absence of such obligations, we would continue our current practice of imposing countervailing duties against subsidized imports without an injury finding.

The code does not seek to eliminate subsidies entirely; rather, its aim is to set guidelines for the use of subsidies which adversely impact on international trade. Developing countries which join the code can fulfill the general obligation to refrain from the use of industrial and mineral export subsidies by assuming obligations regarding the use of these subsidies commensurate with their competitive needs. This provision specifically recognizes that export subsidies are an integral part of many development programs. We realize, for example, that Mexico wishes to adopt certain domestic subsidies to spur development.

But the code also recognizes that subsidies become less necessary as nations develop. This provision is designed to encourage the phaseout of export subsidies as nations become more advanced, and hence have less need for such practices. Nations which accept these responsibilities under the code receive an assurance that, as their subsidies are phased out, their exports will not be countervailed unless injury is shown.

One major ADC has already undertaken such a phaseout commitment and begun to implement it. We hope and expect that Mexico and other advanced developing countries will undertake similar commitments—tailored, of course, to their own development situations.

We do not believe that Mexican obligations under the subsidy code would impair its ability to carry out its development program. Mexico has not relied heavily on export subsidies in the past, although its industry programs may occasionally include such provisions. Mexico's recently announced subsidies too are aimed largely at domestic production, not exports.

In any event, the cardinal point holds—Mexican sales to the United States, and to all of its major markets, will be better protected with Mexico inside the code rather than

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outside it. Useful discussions on this issue have already been held on a technical level. We believe that the time is now ripe to bring these talks to fruition in the form of arrangements for Mexican accession to the subsidy code.

Potential cooperation for the future

Mexico clearly has developed into one of the world's most dynamic and influential developing economies. We welcome Mexico's enhanced status and believe that it offers a firm basis to strengthen overall United States-Mexican relations.

At the same time, Mexico has an important role to play in the international economy and a vital interest in the evolution of world trade relations over the next decade. In order to protect its interests, and to assume its rightful role in the global trading system, Mexico deserves to have an effective voice in the management of these relations. Active and constructive participation in the GATT and the subsidy/CVD code offers a unique opportunity for it to do so.

Both our countries are anxious to obtain the greatest possible benefits from bilateral trade. We know that this is not an easy task. It implies increased commitments and responsibilities. It means greater discipline in the conduct of trade policy. But we firmly believe that the benefits of a more open and flexible world trading system greatly outweigh these considerations. It is our sincere hope that we can work together to help pave the way for greater international trade cooperation and progress in the future.

Exhibit 76.—Excerpt from statement by Under Secretary for Monetary Affairs Solomon, as Alternate Governor for the United States, May 29, 1979, at the 20th annual meeting of the Board of Governors of the Inter-American Development Bank, Montego Bay, Jamaica

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The United States views the developing nations as an integral part of the world economic system, with needs and concerns which must be taken into account in formulating all of our global economic policies, and with responsibilities which affect the functioning of the whole system. The developing countries share our interest in an open international trading and financial system, in stable international monetary arrangements, in helping to promote adequate rates of growth of global production, and in improving the economic well-being of poor people everywhere.

The degree of responsibility assumed by each country should depend on its stage of development. For the poorest countries, we support increased concessional development assistance and preferential treatment in international trading arrangements. We expect the more advanced developing countries to assume greater obligations through the phaseout of preferential treatment, growing participation in efforts to assist the poorer developing countries, and greater collaboration in molding the evolution of the international economic system. In return, these countries have a right to expect that their access to open markets for trade and capital, so essential to their own development, will be maintained.

These twin principles of shared responsibility and the right to participate in international economic decisions have been basic to the concrete actions taken by the United States, along with other nations, to benefit the developing countries over the past 2 years.

In trade, they can be seen in the MTN package in which a number of developing countries will participate directly in the new codes, yet benefit from special and differential treatment. Also improvements in the GATT framework will make it easier for the grievances of developing countries to be heard and for them to influence the evolution of the world trading system.

In commodities, approaching agreements on sugar, natural rubber, and a common fund call for shared producer-consumer financing and decisionmaking with the objective of reducing excessive price volatility around market trends to the benefit of producing and consuming countries alike.

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In development finance, where the amount of U.S. assistance has increased from $5.10 billion in FY 1976 to $7.3 billion in FY 1979, we have given increasing emphasis to the multilateral development banks, for which U.S. contributions have more than tripled over those years. The banks foster a structure of cooperation between developing and developed countries characterized by mutual responsibilities and joint contributions to the health of the international economic and political system. The IDB, the oldest and largest of the regional development banks, exemplifies the cooperative, multilateral approach to effective social and economic development.

The IDB and other multilateral development banks are making great strides toward meeting the needs of poor people and poor countries. We strongly support this effort. The banks are shifting the sectoral composition of their lending activities and changing the emphasis of lending from the more traditional infrastructure projects to those which more clearly assure that the benefits of development are shared by the rural and urban poor. Thus, the IDB and the other banks are actively supporting the efforts of borrowing countries to benefit their poor.

Because of their effectiveness, their development priorities, and their contributions to worldwide economic growth, social progress, and political stability, U.S. support for these institutions, which has been long and unwavering, has grown dramatically in recent years. This year the Carter administration is requesting of the U.S. Congress appropriations for the banks of $3.6 billion.

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TESTIMONY ON INTERNATIONAL MATTERS

Exhibit 77.—Other Treasury testimony in hearings before congressional committees

Secretary Blumenthal

Statement published in hearings before the Joint Economic Committee, 96th Congress, 1st session, regarding the President's economic and budgetary plans for 1979 and 1980, January 31, 1979, pp. 11–18.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, U.S. Senate, 96th Congress, 1st session, regarding appropriations request for the multilateral development banks, March 20, 1979, pp. 541–54.

Statement published in hearings before the Subcommittee on International Economic Policy of the Committee on Foreign Relations, U.S. Senate, 96th Congress, 1st session, regarding the need for international economic cooperation, May 22, 1979, pp. 32–9.

Statement published in hearings before the Committee on Finance, U.S. Senate, 96th Congress, 1st session, regarding the energy crisis as it relates to crude oil, July 10, 1979, pp. 89–97.

Statement published in hearings before the Joint Economic Committee, 96th Congress, 1st session, regarding the Tokyo summit, July 11, 1979, pp. 386–9.

Deputy Secretary Carswell

Statement published in hearings before the Subcommittee on the Panama Canal of the Committee on Merchant Marine and Fisheries, House of Representatives, 96th Congress, 1st session, regarding legislation to implement the Panama Canal treaty of 1977 and related agreement, H.R. 1716, February 26, 1979, pp. 942–47.

Statement published in hearings before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 96th Congress, 1st session, regarding international banking issues and the International Banking Act of 1978, July 16, 1979, pp. 16–21.

Under Secretary for Monetary Affairs Solomon

Statement published in hearings before the Subcommittee on International Finance of the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 96th Congress, 1st session, regarding S. 976, the proposed budget authorization for the Treasury's

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international affairs functions, and recent international monetary developments, May 3, 1979, pp. 100–106.

Statement published in hearings before the Subcommittees on Domestic Monetary Policy and on International Trade, Investment and Monetary Policy of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 96th Congress, 1st session, regarding the Eurocurrency market, July 12, 1979, pp. 249–71.

Assistant Secretary for International Affairs Bergsten

Statement published in hearings before the Subcommittee on Western Hemisphere Affairs of the Committee on Foreign Relations, U.S. Senate, 95th Congress, 2d session, entitled "Economic Relations between the United States and Latin America", October 5, 1978, pp. 126–31.

Statement published in hearings before the Subcommittee on Taxation and Debt Management Generally of the Committee on Finance, U.S. Senate, 96th Congress, 1st session, regarding foreign indebtedness to the U.S., February 5, 1979, pp. 32–8.

Statement published in hearings before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 96th Congress, 1st session, regarding U.S. export control policy and the Export Administration Act, March 6, 1979, pp. 151–61.

Statement published in hearings before the Defense and International Affairs Task Force of the Committee on the Budget, House of Representatives, 96th Congress, 1st session, regarding the budgetary effects of FY 1980 appropriations request for multilateral development banks, March 9, 1979, pp. 118–23.

Statement published in hearings before the Committee on Foreign Relations, U.S. Senate, 96th Congress, 1st session, regarding replenishments of resources for Inter-American Development Bank, Asian Development Fund, and African Development Fund, March 12, 1979, pp. 5–17.

Statement published in hearings before the Subcommittee on International Development Institutions and Finance of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 96th Congress, 1st session, regarding U.S. participation in replenishments—Inter-American Development Bank, Asian Development Fund, and African Development Fund, March 21, 1979, pp. 22–73.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 96th Congress, 1st session, regarding report on international financial institutions prepared by Surveys and Investigations Staff, March 27, 1979, pp. 431–63.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 96th Congress, 1st session, regarding World Bank group, April 3, 1979, pp. 85–113.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 96th Congress, 1st session, regarding African Development Fund, April 3, 1979, pp. 166–79.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 96th Congress, 1st session, regarding Inter-American Development Bank, April 3, 1979, pp. 282–300.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 96th Congress, 1st session, regarding Asian Development Bank, April 3, 1979, pp. 218–38.

Statement published in hearings before the Subcommittee on Foreign Operations of the Committee on Appropriations, House of Representatives, 96th Congress, 1st session, regarding report on international financial institutions prepared by Surveys and Investigations Staff, April 25, 1979, pp. 773–969, *passim.*

Statement published in hearings before the Task Force on Inflation of the House Committee on the Budget, 96th Congress, 1st session, regarding inflation and the external economic position of the United States, July 20, 1979, pp. 5–14.

Statement published in hearings before the Subcommittee on International Institutions and Finance of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 96th Congress, 1st session, regarding report on international financial institutions prepared by Surveys and Investigations Staff, April 24, 1979, pp. 128–39.

Statement published in hearings before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Committee on Government Operations, House of

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Representatives, 96th Congress, 1st session, entitled "U.S. Policy toward Foreign Direct Investment in the United States: The Role of the Committee on Foreign Investment in the United States", July 30, 1979, pp. 60–83.

Statement published in hearings before the Subcommittee on International Finance of the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 96th Congress, 1st session, regarding the importance of exports to the overall strength of the U.S. economy, September 17, 1979, pp. 25–35.

Deputy Assistant Secretary Hufbauer

Statement published in hearings before the Subcommittee on International Trade of the Committee on Finance, U.S. Senate, 96th Congress, 1st session, regarding the President's request to extend the emigration waiver authority for Romania and Hungary under section 402 of the Trade Act of 1974, July 19, 1979, pp. 26–7.

Statement before the Subcommittee on Merchant Marine of the Committee on Merchant Marine and Fisheries, House of Representatives, 96th Congress, 1st session, regarding Title III, promotional policies, of the omnibus maritime bill, July 31, 1979.

Statement before the Subcommittee on Merchant Marine and Tourism of the Committee on Commerce, Science, and Transportation, U.S. Senate, 96th Congress, 1st session, regarding Treasury's views on S. 1460, S. 1462, and S. 1463, bills which propose changes in U.S. regulation of ocean liner shipping, September 19, 1979.

Organization and Procedure

Exhibit 78.—Department of the Treasury orders relating to organization and procedure

NO. 150-87(A), NOVEMBER 2, 1978.—AUTHORITY FOR THE COMMISSIONER OF INTERNAL REVENUE TO FURNISH CERTAIN TAX RETURN INFORMATION TO THE INSPECTOR GENERAL

Pursuant to the authority vested in me as Assistant Secretary (Administration) and by Treasury Department Order No. 150-87, including the provisions of sections 7 and 9 of that Order, and the provisions of the written disclosure authorization provided for in section 6(a) of that Order, I hereby designate the Inspector General of the Treasury Department as a person to whom the Commissioner shall on his own initiative furnish information that a civil penalty for fraud has been assessed, or is proposed for assessment, or an investigation for a possible criminal offense under the internal revenue laws has been commenced or completed with respect to any Treasury officer, employee, or other person serving in the Department described in section 3 or 4 of Treasury Department Order No. 150-87. The Inspector General is also designated to receive any underlying documentation and same will be provided directly to the Inspector General by the Internal Revenue Service when the Inspector General specifically requests such information in writing.

Additionally, the Inspector General is authorized to furnish such information to any persons specified in section 7 of Treasury Department Order No. 150-87 or other Treasury officers who have a need to know such information to the same extent that I have authority under such order to furnish others with such information.

WILLIAM J. BECKHAM, JR.,
Assistant Secretary (Administration).

NO. 102-3, JANUARY 25, 1979—PERSONNEL, PHYSICAL AND AUTOMATIC DATA PROCESSING (ADP) SYSTEMS SECURITY—ORGANIZATION AND DELEGATION OF AUTHORITY

Pursuant to the authority vested in the Secretary of the Treasury by Reorganization Plan No. 26 of 1950 and the authority delegated to me under the provisions of Title 31, Code of Federal Regulations, Part 2; and by Treasury Department Order (TDO) No.

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190 (Revised); TDO No. 200, as Amended; TDO No. 223, as Amended; and TDO No. 254, the following is hereby redelegated:

1. Personnel Security

   a. The Director of Personnel is hereby delegated the authority and responsibility for the Department's functions pertaining to personnel security programs, as set forth in (1) through (9) below:
      (1) Serve as principal adviser to the Assistant Secretary (Administration) in carrying out the personnel security program within the Department pursuant to Executive Order 10450, as amended, and the implementing Federal personnel directives, and supervise the program by developing criteria, policies and guidance.
      (2) Receive all reports of investigation involving loyalty matters on Departmental employees and job applicants and channel those significant matters requiring exceptional attention to appropriate authorities within the Department for processing or resolution.
      (3) Designate position sensitivity for, maintain security files on, and receive and process requests for security clearances concerning the following:
         - Presidential appointees requiring confirmation by the Senate, and occupants of Executive level positions, to the extent of the Department's authority with respect to these employees;
         - Heads of Bureaus and their first deputies;
         - Bureau security officers and any official to whom the authority to grant security clearances has been delegated; and
         - Office of the Secretary personnel.
      (4) Assume jurisdiction over all cases involving a potential determination that an employee in the Department of the Treasury should be suspended, reassigned, or terminated on the grounds that such action is necessary in the interest of the national security.
      (5) Take action, as appropriate, to withhold or withdraw security clearances on employees or potential employees, and to recommend action under Section 7531-32, Title 5, United States Code, and Executive Order 10450, as amended.
      (6) Represent the Department, as required, on all interagency committees and perform liaison functions with Federal agencies involving personnel security matters.
      (7) Make disclosure release determinations on information contained in Office of the Secretary personnel security files pursuant to Section 552, Title 5, United States Code.
      (8) Be responsible for the coordination and documentation of security clearances granted by the Department of Defense through the Industrial Security Program pertaining to contractors, subcontractors, vendors and suppliers participating in Departmental contractual matters involving access to classified material or information under the provisions of Executive Order 10865, as amended.
      (9) Act as Liaison Officer between the Department of the Treasury and the Department of Energy on all matters pertaining to security clearances for access to information or material designated Restricted Data pursuant to the Atomic Energy Act of 1954.

   b. Authority for performing the operating functions relating to personnel security, including the designation of position sensitivity and granting of security clearances, is hereby delegated to the following officials in the Department of the Treasury:
      Director, Bureau of Alcohol, Tobacco and Firearms
      Comptroller of the Currency
      Director, Federal Law Enforcement Training Center
      Commissioner, U.S. Customs Service
      Director, Bureau of Engraving and Printing

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Commissioner, Bureau of Government Financial Operations
Commissioner, Internal Revenue Service
Director, Bureau of the Mint
Commissioner, Bureau of the Public Debt
National Director, U.S. Savings Bonds Division
Director, U.S. Secret Service

c. The authority delegated in Paragraph 1b may be redelegated within Bureau headquarters with the concurrence of the Director, Office of Personnel.

2. Physical Security

a. The Director of the Office of Administrative Programs is hereby delegated the authority and responsibility for the Department's functions pertaining to physical security programs, as set forth in (1) through (13) below:

(1) Serve as principal adviser to the Assistant Secretary (Administration) in carrying out his responsibilities under the provisions of Executive Order No. 12065 and Section 2.29(a) of Title 31, Code of Federal Regulations.

(2) Develop appropriate Departmental security policies, standards, criteria, procedures, and minimum requirements for the classification, downgrading, declassification and safeguarding of national security information in accordance with Executive Order No. 12065, the implementing Information Security Oversight Office Directive No. 1, and implementing Treasury Orders, directives and regulations. Also, conduct an active oversight program to ensure effective implementation and compliance with Treasury's information security program.

(3) Develop and monitor Departmental report requirements established by the Information Security Oversight Office to carry out its function in overseeing Department actions, ensuring compliance with Executive Order No. 12065.

(4) Establish, coordinate, administer and maintain active Departmental training and orientation programs for employees concerned with classified information.

(5) Provide security classification and declassification guidance and systematic review guidelines that are adequate to facilitate the identification and uniform classification of information requiring protection. Also, assure automatic declassification of information not required to be protected because of its national security sensitivity.

(6) Devise and carry out periodic tests of the adequacy of physical security within the Department and ensure that safeguarding practices are continuously reviewed and those which are duplicative and unnecessary are eliminated.

(7) Serve as the focal point within the Department for the receipt, review and processing of all physical security matters which require Departmental action. This includes the enforcement of security regulations as they pertain to classified national security information, sensitive, proprietary and administratively controlled information and the oversight responsibility of physical security program requirements as they impact communications and automatic data processing systems security activities.

(8) Establish policies, procedures and techniques designed to insure an appropriate level of physical protection of Departmental personnel, property and facilities.

(9) Establish and enforce, in conjunction with the Federal Protective Service, General Services Administration (GSA), and in accordance with GSA regulations, policies and procedures for control-

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ling access to Treasury occupied facilities, to include periods of civil disturbances or emergency. This further includes thefts of property and violations of Federal statutes covering other criminal activities committed in or on Treasury occupied space, buildings and grounds under GSA assignment.

(10) Represent the Department on the Security Committee of the National Foreign Intelligence Board.

(11) Represent the Department, as required, on all interagency committees and perform liaison functions with Federal agencies concerned with physical security.

(12) Represent the Department in administering the Departmental Industrial Security Program concerning the safeguarding of all classified information to which Treasury contractors and their subcontractors, vendors or suppliers have access or possession. The administration of this program involves coordination with the Department of Defense who is authorized to act in behalf of the Department in rendering industrial security services pursuant to the provisions of Executive Order No. 10865, as amended.

(13) Develop physical security standards, criteria and procedures and perform the physical security functions for the Office of the Secretary, including security of, and access to, the Main Treasury and Annex Buildings.

3. Automated Data Processing (ADP) Security

a. The Director of the Office of Computer Science is hereby delegated the authority and responsibility for the Department's functions pertaining to ADP security, as set forth in (1) through (6) below:

(1) Serve as principal adviser to the Assistant Secretary (Administration) in developing and coordinating an ADP security program within the Department. The program shall include the protection of sensitive, personal and proprietary data and information in the Department's ADP systems.

(2) Develop appropriate Departmental ADP security policies, procedures, standards, and guidelines to implement a program pursuant to Office of Management and Budget guidance.

(3) Conduct an active oversight program to ensure effective implementation of the Department's ADP Security Program.

(4) Coordinate ADP security planning and prescribe the security requirements for ADP hardware, software, services, and operating procedures.

(5) Represent the Department, as required, on interagency committees and perform liaison functions with Federal agencies involving computer security matters.

(6) Coordinate and maintain an active Departmental orientation and training in ADP security.

b. The authority to prescribe the personnel security policies for ADP security is delegated to the Director, Office of Personnel, as set forth in Paragraph 1 above.

c. The general authority to prescribe the physical security policies for ADP security is delegated to the Director, Office of Administrative Programs, as set forth in Paragraph 2 above.

d. The authority to prescribe the Communications Security (COMSEC) and Emanations Security (EMSEC) policies for ADP security is delegated to Assistant Director (Telecommunications Management), Office of Administrative Programs.

e. The authority to formulate the audit policies for ADP systems security for the purpose of evaluating their adequacy and compliance with established bureau controls, policy and procedures is delegated to the

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Director, Office of Audit for coordination with Treasury bureau audit staffs under TD 10-04.A.

f. The authority to approve computerized information systems subject to National Security regulations is specifically retained by the Assistant Secretary (Administration) and not redelegated by this Order.

The authority delegated by this Order shall be exercised in accordance with Executive Order Nos. 12065 and 10450, as amended, and implementing Treasury regulations, Orders and directives.

Nothing herein is to be construed as deleting or amending the authority contained in Treasury Department Orders cited elsewhere in this Order.

This Order supersedes Treasury Department Order No. 82 (Revised), dated January 17, 1973.

W. J. McDONALD,
Acting Assistant Secretary (Administration).

No. 102-4, March 1, 1979.—Organization of the Office of Administrative Programs

1. By virtue of the authority vested in the Secretary of the Treasury by Reorganization Plan No. 26 of 1950, and pursuant to the authority delegated to me by Treasury Department Order No. 190, Revised, the following are reaffirmed as the functions of the Office of Administrative Programs:

Departmental Program Functions

a. Procurement
b. Personal Property Management, including vehicle management
c. Real Property Management
d. Telecommunications Management, which includes the audio-visual program
e. Paperwork Management, which includes administration of the Privacy Act and Freedom of Information Act
f. Printing Management, which includes publications and graphics programs
g. Physical Security
h. Environmental Programs, which include environmental protection, historic preservation and energy conservation
i. Safety and Occupational Health Programs
j. Library Programs
k. Departmental Voluntary Action Programs

Departmental Centralized Support Functions

a. Operation and maintenance of Main Treasury and Annex Buildings and grounds
b. Telecommunications service
c. Distribution services for directives, legislative and other materials
d. Printing and printing procurement services, including graphic arts
e. Library services
f. Operation of Treasury pass system

Office of the Secretary Support Functions

a. Purchasing and contracting
b. Equipment and supply support
c. Space assignment
d. Facilities coordination activities
e. Paperwork management, including disclosure services
f. Mail, messenger and motor pool services
g. Safety and occupational health activities
h. Protocol support, both domestic and international
j. Travel and transportation arrangements

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2. The Office of Administrative Programs is a component of the Office of the Assistant Secretary (Administration) and functions under the immediate supervision of the Director of Administrative Programs, who reports to the Assistant Secretary (Administration). The Director of Administrative Programs, with the approval of the Assistant Secretary (Administration), shall assign the above functions and responsibilities to the appropriate officials or organizational units within the Office of Administrative Programs.
3. The Departmental Transportation and Travel Regulations function previously assigned to the Office of Administrative Programs is hereby reassigned to the Office of Audit. Personnel, records and equipment are transferred to the Office of Audit.
4. Treasury Department Order No. 194, Revision 3, dated June 10, 1973, and its Amendments 1 and 2, dated April 7, 1976 and September 29, 1977, respectively, are superseded.
5. The effective date of this order is March 11, 1979.

W. J. McDONALD,
Acting Assistant Secretary (Administration).

No. 111-1, March 13, 1979.—Delegation of Authority to Assistant Secretary (Tax Policy) concerning Operation of the Asset Depreciation Range System

Pursuant to the authority vested in the Secretary of the Treasury by Reorganization Plan No. 26 of 1950, supervision of the functions of the Office of Industrial Economics was transferred from the Commissioner of Internal Revenue to the Assistant Secretary (Tax Policy), effective June 11, 1973. Positions, personnel, funds, records, and property of the Office of Industrial Economics, as determined by the Commissioner of Internal Revenue, the Assistant Secretary (Tax Policy) and the Assistant Secretary (Administration), were transferred from the Internal Revenue Service to the Office of the Secretary. See Treasury Department Order No. 175-5, dated June 11, 1973. These transfers remain in force and effect.

Pursuant to the authority vested in me by Sections 167(m), 263(e), and 7701(a)(11) and (12) of the Internal Revenue Code of 1954, authority to establish, supplement, and revise the asset guideline classes, asset guideline depreciation periods and ranges, and annual asset guideline repair allowance percentages, for the Class Life Asset Depreciation Range System is delegated to the Assistant Secretary (Tax Policy), effective on the date of this Order.

Any previous delegations of the authority delegated herein are superseded to the extent they are inconsistent with this Order, effective on the date of this Order.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

No. 101-5, May 16, 1979.—Supervision of Bureaus and Offices, Delegation of Certain Authority, and Order of Succession in the Department of the Treasury

1. The Deputy Secretary shall be under the direct supervision of the Secretary.

2. The following officials shall be under the supervision of the Secretary, and shall report to the Secretary through the Deputy Secretary:

Under Secretary for Monetary Affairs
Under Secretary
General Counsel
Assistant Secretary (Domestic Finance)
(Also reports through Under Secretary for Monetary Affairs for debt management purposes.)
Assistant Secretary (Economic Policy)
Assistant Secretary (Legislative Affairs)
Assistant Secretary (Public Affairs)

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Assistant Secretary (Tax Policy)
Executive Secretary
Comptroller of the Currency
Commissioner of Internal Revenue
Inspector General
Director, Office of Small and Disadvantaged Business Utilization

3. The following officials shall be under the supervision of the Under Secretary for Monetary Affairs, and shall exercise supervision over those officers and organizational entities listed:

Assistant Secretary (International Affairs)
- Deputy Assistant Secretary for Developing Nations
- Deputy Assistant Secretary for Trade and Investment Policy
- Deputy Assistant Secretary for Commodities and Natural Resources
- Deputy Assistant Secretary for International Monetary Affairs
- Deputy to the Assistant Secretary for Saudi Arabian Affairs
- Deputy to the Assistant Secretary and Secretary of International Monetary Group
- Inspector General for International Finance

(The Assistant Secretary (Domestic Finance) reports through the Under Secretary for Monetary Affairs for debt management purposes.)

Fiscal Assistant Secretary
- Deputy Fiscal Assistant Secretary
- Commissioner, Bureau of Government Financial Operations
- Commissioner of the Public Debt

4. The following officials shall be under the supervision of the Under Secretary, and shall exercise supervision over those officers and organizational entities listed:

Assistant Secretary (Administration)
- Deputy Assistant Secretary (Administration)
- Director, Office of Administrative Programs
- Director, Office of Audit
- Director, Office of Budget and Program Analysis
- Director, Office of Computer Science
- Director, Office of Equal Opportunity Program
- Director, Office of Management and Organization
- Director, Office of Personnel

Assistant Secretary (Enforcement and Operations)
- Deputy Assistant Secretary (Operations)
- Deputy Assistant Secretary (Enforcement)
- Director, Bureau of Alcohol, Tobacco and Firearms
- Commissioner of Customs
- Director, U.S. Secret Service
- Director, Federal Law Enforcement Training Center
- Director, Office of Foreign Assets Control

Treasurer of the United States
- National Director, U.S. Savings Bonds Division

Director, Bureau of the Mint
Director, Bureau of Engraving and Printing

5. The following officials shall exercise supervision over those officers and organizational entities listed:

General Counsel
- Deputy General Counsel
- Legal Division
- Office of Director of Practice
- Deputy Assistant Secretary (Tariff Affairs)

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Assistant Secretary (Domestic Finance)
  Deputy Assistant Secretary for Debt Management
  Senior Adviser (Debt Research)
  Director, Office of Government Financing
  Director, Office of Agency Finance and Market Policies
  Deputy Assistant Secretary for Capital Markets Policy
  Director, Office of Securities Market Policies
  Director, Office of Capital Markets Legislation
  Deputy Assistant Secretary for State and Local Finance
  Director, Office of Municipal Finance
  Director, Office of New York Finance
  Director, Office of Urban Economics
  Director, Office of Revenue Sharing
Assistant Secretary (Economic Policy)
  Deputy Assistant Secretary for Domestic Economic Policy
  Director, Office of Financial Analysis
  Director, Office of Special Studies
  Energy Legislative and Regulatory Analysis Staff
  Deputy Assistant Secretary for International Economic Analysis
  Director, Office of Monetary Research
  Director, Office of Trade Research
  Director, Office of Balance of Payments
  Director, Office of International Energy Research
  Director, Office of Statistical Reports
  Director, Office of Data Services
  Foreign Portfolio Investment Survey Project
Assistant Secretary (Legislative Affairs)
  Deputy Assistant Secretary (Legislative Affairs)
  Office of Legislative Affairs
Assistant Secretary (Public Affairs)
  Deputy Assistant Secretary (Public Affairs)
  Office of Public Affairs
Assistant Secretary (Tax Policy)
  Deputy Assistant Secretary for Tax Analysis
  Associate Director, Office of Tax Analysis
  Deputy Assistant Secretary for Tax Legislation
  Office of Tax Legislative Counsel (also part of Legal Division)
  Office of International Tax Counsel (also part of Legal Division)
  Director, Office of Industrial Economics

6. The Deputy Secretary, the Under Secretary for Monetary Affairs, the Under Secretary, the General Counsel, and the Assistant Secretaries are authorized to perform any functions the Secretary is authorized to perform. Each of these officials shall perform functions under this authority in his or her own capacity and under his or her own title and shall be responsible for referring to the Secretary any matter on which action should appropriately be taken by the Secretary. Each of these officials will ordinarily perform under this authority only functions which arise out of, relate to, or concern the activities or functions of, or the laws administered by or relating to, the bureaus, offices, or other organizational units over which the incumbent has supervision. Any action heretofore taken by any of these officials in the incumbent's own capacity and under his or her own title is hereby affirmed and ratified as the action of the Secretary.
7. The following officers shall, in the order of succession indicated, act as Secretary of the Treasury in case of the death, resignation, absence, or sickness of the Secretary and other officers succeeding the incumbent, until a successor is appointed, or until the absence or sickness shall cease:
   A. Deputy Secretary
   B. Under Secretary for Monetary Affairs
   C. Under Secretary

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D. General Counsel
E. Assistant Secretaries, or Deputy Under Secretaries, appointed by the President with Senate confirmation, in the order in which they took the oath of office as Assistant Secretary, or Deputy Under Secretary.

8. Treasury Department Order No.190 (Revision 15), March 16, 1978, is rescinded.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 101-6, MAY 16, 1979.— ESTABLISHMENT OF THE OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION

By virtue of the authority vested in me as Secretary of the Treasury including the authority of the Reorganization Plan No. 26 of 1950, there is hereby established in the Office of the Secretary the Office of Small and Disadvantaged Business Utilization. This Office shall be headed by a Director who shall be appointed by the Secretary of the Treasury. The duties of the Director shall be performed under the direct supervision of the Deputy Secretary of the Treasury.

The Director shall perform these duties and responsibilities as required by Public Law 95-507, and in accordance with Sections 8 and 15 of the Small Business Act as amended, and such other functions and duties that may be delegated to the Director.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 145-10, JULY 2, 1979.—RESPONSIBILITY FOR PREPARATION OF THE ANNUAL REPORT OF THE SECRETARY ON THE STATE OF THE FINANCES AND OF THE TREASURY BULLETIN

By virtue of the authority vested in me as Secretary of the Treasury by Reorganization Plan No. 26 of 1950, it is hereby ordered that the preparation of the Annual Report of the Secretary of the Treasury on the State of the Finances (31 U.S.C. 1027), and of the Treasury Bulletin shall be the responsibility of the Bureau of Government Financial Operations.

These functions were transferred March 1, 1953 from the Office of the Technical Staff to the Bureau of Accounts, which has been merged into the Bureau of Government Financial Operations.

This order supersedes Treasury Order No. 170-1, dated February 27, 1953.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 145-11, JULY 2, 1979.—DELEGATION TO COMMISSIONER OF THE BUREAU OF GOVERNMENT FINANCIAL OPERATIONS OF AUTHORITY RELATING TO ADMINISTRATION OF FUNDS TO PAY ALLOWANCES TO FORMER PRESIDENTS AND THEIR WIDOWS

By virtue of the authority vested in me by Reorganization Plan No. 26 of 1950, the authority conferred upon the Secretary of the Treasury by Public Law 85-745, approved August 25, 1958, relating to administration of funds made available to pay monetary allowances to former Presidents and pensions to widows of former Presidents, is hereby delegated to the Commissioner of the Bureau of Government Financial Operations.

The Commissioner of the Bureau of Government Financial Operations may redelegate the authority transferred herein to such subordinates in the Bureau as deemed necessary.

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Treasury Department Order No. 177-17, dated September 22, 1958, is hereby rescinded.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

NO. 101-3, JULY 16, 1979.—DELEGATION OF PROCUREMENT AUTHORITY TO OFFICE OF ADMINISTRATIVE PROGRAMS AND TREASURY BUREAUS

Pursuant to the authority vested in me as Assistant Secretary (Administration) by Treasury Department Order No. 208, Revision 4, it is hereby ordered as follows:

1. The authority to prescribe and publish Treasury Procurement Regulations is hereby delegated to the Director, Office of Administrative Programs, Office of the Secretary, without the power of further redelegation.

2(a). The following officials of the Department of the Treasury are hereby delegated the authority to procure property and services consistent with Title III of the Federal Property and Administrative Services Act of 1949 (Act), as amended (41 USC 251-260), except as precluded by Section 307 (41 USC 257) of the Act:

Director, Office of Administrative Programs, Office of the Secretary
Director, Bureau of Alcohol, Tobacco, and Firearms
Comptroller of the Currency
Commissioner of Customs
Director, Bureau of Engraving and Printing
Director, Federal Law Enforcement Training Center
Commissioner, Bureau of Government Financial Operations
Commissioner of Internal Revenue
Director of the Mint
Commissioner of the Public Debt
National Director, U.S. Savings Bonds Division
Director, U.S. Secret Service

(b) Each of the officials named in (a) is deemed "chief officer responsible for procurement" within the meaning of 41 USC 257(b).

3. The authority delegated includes but is not limited to taking the following actions:
   (a) to enter into and take all necessary actions with respect to purchases, contracts, leases, and other contractual procurement transactions;
   (b) to make determinations and decisions with respect to procurement matters, except those determinations and decisions required by law or regulation to be made by other authority; and
   (c) to designate persons qualified in procurement matters as Contracting Officers and representatives thereof, in accordance with requirements and procedures established in Section 1.404 of the "Treasury Procurement Regulations."

4. The authority delegated herein shall be exercised in accordance with the applicable limitations and requirements of the Act; the Federal Procurement Regulations, 41 CFR Chap. 1; the applicable portions of the Federal Property Management Regulations, 41 CFR Chap. 101; as well as regulations issued by the Department of the Treasury which implement and supplement the Federal Procurement Regulations and the Federal Property Management Regulations including but not limited to 41 CFR Chap. 10 and Treasury Directives Manual Chapter 70-06, "Treasury Procurement Regulations."

5. To the extent permitted by the Act and this delegation, the authority herein delegated to the above-named officials may be redelegated by them by letter or bureau order to any subordinate officer or employee who has been duly designated to act as a Contracting Officer for the United States.

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This Order supersedes Department of the Treasury Order 101-3, dated January 16, 1979.

W. J. McDONALD,
Assistant Secretary (Administration).

No. 102-5, SEPTEMBER 21, 1979.— ORGANIZATIONAL CHANGES, OFFICE OF THE ASSISTANT SECRETARY (ADMINISTRATION)

By virtue of the authority vested in the Secretary of the Treasury by Reorganization Plan No. 26 of 1950, and pursuant to the authority delegated to me by Treasury Order No. 101-5, the following organizational changes are made within the Office of the Assistant Secretary (Administration).

1. The Departmental Paperwork Management functions are hereby transferred from the Office of Administrative Programs and made a part of the Management Analysis Division, under the immediate supervision of the Chief, Management Analysis Division. These include specifically the policy functions relating to the Departmental Directives Management Program, Reports Management Program, Forms Management Program, Records Management Program, Word Processing Management Program, and Microform Management Program. Personnel, records and equipment are transferred to the Management Analysis Division.
2. The Emergency Preparedness functions are hereby transferred from the Office of Management and Organization and made a part of the Office of Administrative Programs. Personnel, records and equipment are transferred to the Office of Administrative Programs.
3. The Office of the Secretary Travel Policy functions are hereby transferred from the Office of Administrative Programs and made a part of the Office of Audit. Personnel, records and equipment are transferred to the Office of Audit.
4. The functions of the Assistant Director (Operations) are hereby transferred from the Office of Personnel to the immediate Office of the Assistant Secretary (Administration). Personnel, records and equipment are transferred to the immediate Office of the Assistant Secretary (Administration).
5. The Office of the Secretary Financial Manager functions are hereby transferred from the Office of Management and Organization to the immediate Office of the Assistant Secretary (Administration). Personnel, records and equipment are transferred to the immediate Office of the Assistant Secretary (Administration).
6. The Treasury Payroll/Personnel Information System Division functions are hereby transferred from the immediate Office of the Assistant Secretary (Administration) to the Office of Administrative Programs. Personnel, records and equipment are transferred to the Office of Administrative Programs.
7. Paragraphs 1 through 5 of this Order were effective on April 23, 1979. Paragraph 6 is effective on September 23, 1979.
8. This order supersedes Treasury Order No. 102-5 dated April 17, 1979.

W. J. McDONALD,
Assistant Secretary (Administration).

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